

the CATO JOURNAL

AN INTERDISCIPLINARY JOURNAL OF PUBLIC POLICY ANALYSIS

THE FUTURE OF THE WTO

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EDITOR'S NOTE

People often forget that poverty is the natural condition of mankind and that widespread wealth creation is a relatively recent phenomenon in the long span of human history. The material progress that has occurred in the last 200 years has been possible largely because people have been free to trade—both domestically and internationally.

But that freedom is precarious. There is a constant threat of protectionism from special interest groups determined to prevent competition from undermining their market shares, as if those shares were a natural right. In addition, if the public fails to understand the long-term benefits of free trade, in terms of preserving a free society and creating wealth, short-run considerations may block trade liberalization.

The demonstrations that shook the World Trade Organization meeting in Seattle last December revealed a basic ignorance of simple economic principles and a willingness to let blind emotion crowd out logic and foresight. The reality is that countries that have blocked commercial contacts with the West, limited the scope of private traders, and attenuated property rights have had slower development and greater environmental degradation than more open economies.

This special issue of the *Cato Journal* examines **The Future of the WTO**, with the key question being whether that future is consistent with market-liberal principles. Will the WTO be a friend or potential foe of trade liberalization? How can that organization be improved in order to ensure that it promotes rather than hinders the free movement of commodities and capital? Should environmental and labor standards be part of the WTO? Do the antidumping provisions of the WTO unfairly protect the United States and other advanced economies and discriminate against less developed countries?

Those and other important questions are addressed in this volume, which is based on a conference organized by the Center for Trade Policy Studies at the Cato Institute. I thank *Dan Griswold*, associate director of the Center, for his role in organizing that conference and for acting as guest editor for this special issue.

—J. A. Dorn

INTRODUCTION

THE FUTURE OF THE WTO

Daniel T. Griswold

A Crucial Moment in U.S. Trade Policy

Once an obscure international body tucked away in Geneva, Switzerland, the World Trade Organization (WTO) has become almost a household word in the United States today. Its name recognition rose dramatically in fall 1999 when tens of thousands of protestors took over the streets of Seattle at the beginning of the WTO's November 30–December 3 ministerial meeting. The demonstrators seemed to blame the WTO for undermining all that is good in the world—from democracy and living standards to air quality and sea turtles. The protests were followed later in the week by the collapse of talks among the WTO's more than 100 members, talks that were supposed to launch a new round of multilateral trade negotiations.

This double failure—to persuade hearts and minds outside the negotiating rooms and to achieve consensus within—was an undeniable setback for the WTO and free trade. Events in Seattle invigorated opponents of the WTO, weakened its base of support in Congress, and revived questions about the desirability of trade liberalization itself as a goal of U.S. policy. More so than anytime since its founding, doubts are being raised about the future of the WTO.

Those doubts need to be met head-on. Both the WTO and, before it, the General Agreement on Tariffs and Trade have played an important role in expanding international trade during the post-World War II era, which in turn has helped to spread prosperity to a widening circle of humanity. When representatives of 23 mostly industrialized nations met in 1947 to sign the original General Agreement on Tariffs and Trade (GATT) treaty, the world economy was still on its knees

after the trade wars of the 1930s and the world war that followed. Since then, membership in the GATT/WTO has grown to 136, with less developed countries now representing four-fifths of its membership and with another 30 countries, including China and Russia, seeking to join.

Through eight rounds of negotiations over five decades, the GATT and now the WTO have helped to dramatically lower global tariffs on manufactured goods, as well as to lock in those lower barriers with “bindings” that set upward limits on tariff rates. Due in no small part to those agreements, the volume of world trade has exploded 16-fold since 1950, a rate of growth three times faster than global output (OECD 1998: 31). For the United States, WTO membership has worked to open markets abroad for our exports while reducing our own trade barriers to the benefit of consumers and import-using producers.¹

The current controversy surrounding the WTO comes at a crucial time in U.S. trade policy. This year Congress will vote on whether to grant permanent normal trade relations to the People’s Republic of China (PRC), which, in turn, will facilitate the PRC’s entry into the WTO. Congress will then vote on a resolution to withdraw the United States from the WTO. And during the fall 2000 national elections for president and Congress, organized labor promises to make the trade issue a litmus test for its support.

At this juncture of the trade debate, it is more important than ever to reexamine why trade liberalization is good for rich and poor nations alike, as well as what role, if any, the World Trade Organization should play in promoting it. This special issue of the *Cato Journal* examines the future of the WTO and its likely impact on the prospects for trade liberalization at home and abroad. Each of the articles was originally presented at the Cato Institute’s Center for Trade Policy Studies conference, “Seattle and Beyond: The Future of the WTO,” held in Washington on November 17, 1999.

An Overview of Articles

The first three articles address the fundamental question of how a multilateral trade organization can advance the cause of free trade. *Douglas Irwin*, professor of economics at Dartmouth College, affirms the economic case for unilateral free trade, while drawing on history—both America’s long record of unilateral protectionism and the disas-

¹For a detailed discussion of the beneficial impact of WTO membership on the U.S. economy, see Griswold (2000).

trous interwar years of beggar-thy-neighbor trade wars—to make a political economy case for reciprocal trade negotiations. He warns that the future of the WTO is clouded by the efforts of its friends and foes alike to expand its agenda into areas such as competition policy and labor and environmental regulation that go beyond the WTO's historical mission of reducing trade barriers.

Brink Lindsey, director of the Cato Institute's Center for Trade Policy Studies, challenges the conventional trade wisdom that negotiations are the only or the most important path to trade liberalization. The impetus for trade reforms in New Zealand, Australia, Mexico, China, India, and dozens of less developed countries in the past two decades came not from "top-down" pressure through international institutions but from the "bottom up" through changing perceptions of national economic interest. "Freedom of international exchange thus flows up from below as a necessary consequence of predominantly unilateral decisions at the national level," Lindsey concludes. Nonetheless, multilateral trade negotiations can help to solidify domestic political support for liberalization and to lock in gains through agreements.

To best advance the cause of free trade, the WTO should stick to what it does best: facilitating trade liberalization and arbitrating disputes among its members. *William H. Lash III*, professor at the George Mason University School of Law, warns that the WTO could be hijacked by political interests that do not share its basic agenda. "Denying access to the U.S. market because of our environmental or labor values opens the floodgates to a host of morality-driven trade restrictions, jeopardizing the multilateral trading framework," Lash writes.

The shape of a new round of trade negotiations is the focus of the second group of papers. *Jeffrey Schott*, a senior fellow at the Institute for International Economics, dissects the failed WTO ministerial meeting in Seattle. He points out that one of the major obstacles was the differing perceptions among the advanced and less developed economies about what a new round should achieve. He urges a broader agenda to achieve a "critical mass" of issues, one that encompasses areas such as antidumping laws and other protectionist barriers that are harmful to less developed countries but are politically important to the U.S. government.

The two areas offering the greatest potential for gains are agriculture and services, both of which will be the subject of negotiations this year as part of the "built-in agenda" carried over from the 1994 Uruguay Round Agreements. *Kym Anderson*, professor at the School of Economics at the University of Adelaide, and *Paul Morris*, assistant secretary at the Department of Agriculture, Fisheries, and Forestry

in Australia, document the huge potential gains in world welfare from agricultural trade liberalization. Using a global economy-wide model, they estimate that almost one-third of potential global gains from trade liberalization would come from agriculture alone. They describe the most promising areas for and the chief obstacles against agricultural trade liberalization.

Equally significant trade gains could be realized in the service sector, where the United States is globally competitive in a broad range of industries. *J. Robert Vastine*, president of the Coalition of Service Industries, describes the sectors with the greatest potential for liberalization as he argues for an aggressive agenda for U.S. negotiators. "The United States should enter new negotiations with a bold agenda, calling for sweeping commitments to liberalization across as many sectors as possible. New sectors requiring attention in a new round should include energy services, health services, air cargo services, as well as financial services, telecommunications, and others," Vastine writes.

The third group of articles analyzes the special challenges facing less developed countries in multilateral trade negotiations. *Razeen Sally*, senior lecturer in International Political Economy at the London School of Economics and Political Science, describes the rising influence of developing and transition countries within the WTO, as well as the opportunities this influence presents for faster trade liberalization and growth among less developed countries. He concludes that those countries should seek a "single undertaking" during the next round in which all agreements are accepted in their entirety and applied to all WTO members. Less developed countries should also insist that textile and apparel quotas be phased out as agreed, that antidumping laws be reformed and industrial tariffs be lowered, and that Western-style environmental and labor standards be rejected as inappropriate for poorer countries.

J. Michael Finger, lead economist for trade policy at the World Bank, documents how the WTO—by going beyond the narrow trade liberalization agenda of the old General Agreement on Tariffs and Trade—has placed a special burden on its less developed members. Specifically, he explains how the WTO rules regarding intellectual property rights, customs reform, and sanitary and phytosanitary regulations impose real costs on less developed countries but may not yield enough offsetting benefits to justify the expenditure of scarce resources. When the issue was trade liberalization under the GATT, "an economist could in good faith urge that a country—industrial or developing—overcome domestic politics and meet its obligations," Finger writes. "For the WTO, one cannot."

The final group of articles tackles the perennial political problem of building domestic support for free trade. *Russell Roberts*, visiting professor at the Center for the Study of American Business at Washington University, urges the advocates of trade liberalization to do the following: avoid lies, such as the claim that “trade creates jobs”; speak plainly; illuminate the unseen; and bring trade to life. “Trade determines the kinds of jobs we have in this country, not the total number,” Roberts concludes. “This is not exactly a romantic slogan to go to the barricades for. But it is true, and when fleshed out with a little bit of analysis of the unseen, it can begin to make a case for free trade that may speak to the open-minded skeptic.”

Ron Cass, dean of the Boston University School of Law, explains why promoting free trade has always been an uphill battle. Opponents of trade enjoy an inherent advantage because its negative consequences—some closed factories and displaced workers—are usually more visible and accessible than the larger positive consequences which tend to be more diffused and less directly connected to trade. As a consequence, opponents of trade are also more politically intense. To offset this bias, Cass argues for a more activist agenda for domestic companies that export or rely on imports as a major component of production, along with a concerted effort to educate the public on the benefits of trade.

Finally, *William A. Niskanen*, chairman of the Cato Institute and former acting chairman of President Reagan’s Council on Economic Advisers, argues that the best hope for future trade liberalization through the WTO is to build on the organization’s proven record of success. “The World Trade Organization may be the single most effective international agency,” Niskanen writes. In contrast to the World Bank and the International Monetary Fund, the WTO “has been focused on modest and broadly shared trade concerns—modest because the WTO, almost alone among international bureaucracies, has self-consciously resisted both internal and external pressures to expand its mission.”

Together, the articles in this issue make a compelling case for the important, if imperfect and limited, role of the WTO in expanding the frontiers of economic liberty. Through ongoing unilateral actions and future multilateral negotiations, barriers to trade can be lowered still further, delivering a higher standard of living to workers in advanced and less developed countries alike.

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DO WE NEED THE WTO?

Douglas A. Irwin

The failure of the World Trade Organization ministerial summit late last year has thrown the future course of trade liberalization onto an uncertain track. Added to this uncertainty is increasing criticism of the WTO itself, and not just from the anti-globalization protesters who congregated in Seattle. Some of those who embrace the cause of trade liberalization also have questioned the efficiency of the multilateral negotiations approach, suggesting that either unilateral or regional trade agreements may be more efficacious in achieving lower trade barriers.

This article makes the case for the WTO, a limited case but (one hopes) a compelling one nonetheless. That case is in large measure political, and one needs a historical perspective on U.S. trade policy to appreciate that political case. The article then discusses the limits to what can be achieved through the WTO.

Reciprocity and Unilateralism in U.S. Trade Policy

If economists' view of the world held sway among policymakers, there would be no need for the WTO. The economists' case for free trade is essentially a unilateral case—that a country is better off pursuing a policy of free trade regardless of the policies pursued by others. As the 19th-century French economist Frederic Bastiat put it, a country should not throw rocks in its harbors simply because other countries have rocks in theirs.

While the economic logic behind this proposition is impeccable, it has not proved politically palatable. Thus, we find ourselves in a world in which reciprocity comprises a big part of the trade policy game, and countries negotiate with one another about their trade barriers.¹

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Douglas A. Irwin is professor of economics at Dartmouth College and a research associate of the National Bureau of Economic Research.

¹See Krugman's (1997) discussion of what trade negotiators should negotiate about.

The mercantilist logic and language of international trade negotiations—that a reduction in our own trade barriers is a “concession” to others—can be jarring in terms of the underlying economics. But there is an important political logic behind reciprocity that makes the WTO an extremely useful institution. In the end, we should judge the WTO (or any public institution, for that matter) as good or bad only in relation to its alternatives—a very utilitarian standard. The WTO is far from perfect, of course, but we should ask the questions: What purpose does the WTO serve? and Would the world be a better place without the WTO?

In answering these questions, we have some historical experience to draw on—namely, 150 years of unilateral trade policy in the case of the United States. The Constitution grants the Congress of the United States authority over taxes and impositions on foreign commerce. Unilateral free trade in the United States therefore long has meant congressional trade policy—which was the case from 1789 until 1934 and the passage of the Reciprocal Trade Agreements Act. That system was hopelessly biased in favor of domestic interests seeking protection from foreign competition (see Schattschneider 1935). If you think the mercantilist logic of multilateral trade negotiations is lamentable, try reading the hearings held when Congress was considering the passage of any trade legislation in the 19th century, or the Smoot-Hawley tariff in 1929 and 1930. Try to sort out what is meant by a tariff that will “equalize the costs of production” between domestic and foreign producers. When I try to sort it out, I am reminded of Ross Perot, Pat Buchanan, and Michael Lind talking about a “social tariff” designed to equalize wage differences between countries. That is tantamount to throwing rocks in our harbors not because others have rocks in theirs, but because we like rocky coasts—we deliberately want to limit our trade. For the United States, I would suggest, historical experience indicates that a reciprocity-based trade policy in the hands of the executive beats a unilateral trade policy in the hands of Congress (see Irwin 1998).

The other piece of historical evidence comes from the interwar trade policy experience. That period demonstrated that there is, to some degree, a political interdependence—an externality or spillover effect—of one country’s trade policy on those of its trading partners. When the United States and the United Kingdom imposed trade barriers in the early 1930s in response to the economic recession that soon became the Depression, they made it harder for other countries to resist going down that path, too—in terms of either provoking retaliation, which Canada did to the United States, or setting an example that affects the political economy of tariffs in other countries.

Congress thought that trade policy was domestic policy, pure and simple, and did not take into account the international systemic effects of U.S. actions on the trade policies of other countries.

So the General Agreement on Tariffs and Trade was formed in 1947 to allow for the international negotiation of reductions in trade barriers. The built-in bias of the GATT is good from the economists' perspective—the freeing of international trade. No international organization is needed to coordinate the raising of trade barriers on each others' commerce—countries can do that quite nicely on their own. So the thrust and the purpose of the GATT since then has been mainly to the good because its mandate is mainly to the good.

The Political Case for the WTO

The case for the GATT and the WTO that I have set out is mainly a political case—that the WTO is useful because it changes the political economy of trade policy in a way that tends to facilitate trade liberalization as an outcome.² But there are limits.

First, the WTO is a forum for the pursuit of trade liberalization, but it is not the only method of achieving that goal. Despite the historical difficulties of unilateral trade policy in the U.S. context, unilateral trade liberalization operating outside of the WTO is not only extremely important, but in many ways stronger and deeper when it is achieved outside the WTO. As Brink Lindsey mentions in his article, countries such as New Zealand, Chile, Mexico, and others have pursued trade policy reforms such as tariff reductions outside of multilateral trade negotiations. Such liberalization is based on a domestic political consensus about their national economic interest in such liberalization regardless of policies pursued abroad. The motivation is not reciprocity but an acceptance of the efficiency benefits that will accompany such liberalization.

Even in the United States, when public policy toward certain sectors is not viewed as falling under the rubric of “trade policy” (i.e., any non-U.S. Trade Representative or Commerce Department issue), deregulation effectively amounts to unilateral trade liberalization. When the United States deregulates the telecommunications industry, or changes its policy toward financial services, it generally does not discriminate against foreign firms. Those sectors are open to international competition regardless of the illiberal policies pursued in other countries. The benefits that arise from such unilateral U.S. actions

²Irwin and Kroszner (1999) show that the Reciprocal Trade Agreement Act system achieved bipartisan support around World War II because that system made members of Congress more sensitive to export-oriented interests.

have a positive demonstrative effect on the policies of other countries, just as there was a negative demonstrative effect in the 1930s. The dramatic price reductions and vast opportunities created by telecom deregulation have proved so compelling that other countries have been induced to follow the U.S. example. The United States was far ahead of the rest of the world in deregulation, and much would have been lost if the United States waited for other countries to agree to an international agreement on such matters. When global negotiations delay the enactment of inherently desirable liberalization by making it contingent on an international consensus, the value of those negotiations is brought into question (see Barfield and Irwin 1997).

The case for the WTO is also limited in that we should never confuse international trade rule-making with the objective of trade liberalization. The WTO can be a mechanism to codify and institutionalize bad trade policy, as J. Michael Finger has often pointed out. The Multifiber Arrangement is an example, and the Balance of Payments and other GATT-legal justifications for protection are bad exceptions to build into international trade rules.

So, although I believe that the WTO has proved to be an extremely useful institution for freer trade, and has certainly proved to be a more valuable international economic institution than the World Bank or the International Monetary Fund, there are qualifications to that belief.

Let me turn to the future of the WTO. At almost any point in time over the postwar period, one could be justified in having grave concerns about the future direction of the world trading system.³ The main reflex of some trade policy analysts is to wring their hands and fret at the outlook for the world trading system. While this pessimism is often warranted, we should reflect on where the system stands today compared with the failure of the 1982 GATT ministerial meeting when all looked bleak. Since then, substantial progress has been made in reforming trade policies.

Perhaps we should temper our fears for the future. I wish I could say that because the United States now enjoys a period of low unemployment and stable growth, such concerns are not justified today. But I am afraid that both friends and foes of the WTO want to expand or distort its agenda in ways that will prove harmful to the central WTO mission.

Friends of the WTO want to see it expand its scope to set rules that will cover all sorts of new trade issues, ranging from investment

³Jackson (1978) reflects the deep-seated pessimism of many trade policy analysts in the late 1970s and early 1980s.

and competition policy to e-commerce and product standards. That push comes as part of the “bicycle theory” of trade liberalization, which illustrates that we must continually keep pedaling and move the agenda forward because if we ever stop, we will lose the momentum achieved by successive negotiations and fall prey to backsliding. I think this is a misreading of the history of the GATT negotiations, in which there have been several long pauses in GATT activities. Yet, when the leading contracting parties were ready, they once again resumed negotiations.⁴ Those pauses are good in that they allow members to digest previous agreements and conserve energy for future multilateral trade negotiations. A case can be made that the United States is still digesting the North American Free Trade Agreement and the Uruguay Round. Sometimes it is good to stop the bicycle to rest and see where we are headed. If we just pedal merrily along, seeking agreements in this area and that, we run the risk of creating a regulatory WTO, not really liberalizing trade (after all, that is a tough thing to do) but writing regulations that may or may not move us in the direction of freer trade.

The last thing we should want to create is an international regulatory bureaucracy in Geneva that will provide full employment for trade lawyers rather than truly open up markets. As Margaret Thatcher complained years ago, she did not stop growth of the state in the United Kingdom only to see it reemerge from Brussels. The strength of the WTO (versus the World Bank or the International Monetary Fund) over the postwar period has been its relatively small size and narrowly defined agenda. The reason the proposed International Trade Organization was defeated in the late 1940s was that U.S. business feared that the ITO was as much about regulating resale price maintenance and other business practices as about cutting tariffs.

We should keep the WTO focused as much as possible on reducing border measures and not expand its agenda hastily by groping for new issues (many of which are going nowhere fast anyway) when there is plenty to do on the old issues. The next round, perhaps, should be a mini-round, a clean-up round, that focuses on ensuring that the Uruguay Round commitments have been fulfilled—particularly in agriculture and on eliminating the Multifiber Arrangement. Agriculture and textiles alone account for 20 percent of world trade and both are littered with trade restrictions. The world would have been done a great service if the WTO were able to liberalize restrictions in those areas and perhaps move toward zero tariffs on industrial products.

⁴Irwin (1995) discusses how multilateral negotiations were essentially dead in the water in the 1950s and early 1960s.

Foes of the WTO also want to overload the agenda with issues such as labor standards and environmental regulations. No compelling case exists for putting rules about labor standards in a trade liberalization forum. Developing countries are rightly suspicious that the attempt by Western nongovernmental organizations (NGOs) to foist rules and regulations on them will eventually provide the excuse for developed countries to hinder the ability of developing countries to export. The environmental issues are even more complex than labor issues, but the charges that have been leveled at the WTO by environmental NGOs are often completely misleading regarding the tension between environmental and trade policies.⁵

The vociferous hostility being vented on the WTO is astounding, especially since so much of it is based on ignorance of what the WTO actually does. Contrary to its critics' beliefs, the WTO is not some independent creature but is purely the creation of its members. Friends of the WTO face an enormous challenge in dealing with these groups and responding to the charges they make.

That case has not been made as strongly as it needs to be by the administration. The Council of Economic Advisers (1999) has issued a sound report on the U.S. interest in the WTO, but a forceful defense of the WTO is required by the actual policymakers. In light of the events in Seattle, the WTO is going to need all of the friends it can get in coming months.

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⁵The common complaint is that WTO rulings have undermined domestic environmental standards, as in the gasoline regulation case won by Venezuela. The issue in that case, however, was not the stringency of the U.S. regulations, but the Environmental Protection Agency's decision to apply one standard to domestic gasoline and another, more stringent standard to foreign gasoline. The WTO found that this was unfair discrimination, and most such cases hinge only on violation of the nondiscrimination, most-favored-nation clause in the WTO. The EPA complied with the ruling by relaxing its requirements for foreign refiners, but it could just as easily have tightened them for domestic ones. See Irwin (1999).

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FREE TRADE FROM THE BOTTOM UP

Brink Lindsey

In determining the proper course of future WTO negotiations, it is useful to ask a very basic question at the outset. Namely, why have international trade negotiations in the first place?

The question posed here is addressed to free traders, not protectionists. Of course protectionists oppose trade talks; they do so because they oppose open markets. But just because protectionists are against trade negotiations does not mean that free traders should automatically embrace them.

That suggestion might seem baffling at first, since the cause of free trade and the vehicle of trade negotiations are so inextricably connected in the prevailing conventional wisdom. But if we step back from current preconceptions and examine the underlying economic and political realities, the need to pursue trade liberalization through international negotiations begins to look much less obvious.

In trade negotiations, countries offer to reduce import barriers in exchange for other countries' offers of equivalent reductions. In other words, liberalization at home is made contingent upon liberalization abroad. Indeed, according to the rhetoric of negotiations, removal of domestic protectionist policies is treated as the price to be paid for freer markets elsewhere. Countries "gain" access to other nations' markets in exchange for which they "give up" greater access to their own. Thus, in official GATT parlance, commitments to open one's own market are labeled "concessions" while other countries' commitments to open their markets are labeled "benefits."

The rhetoric of negotiations, however, turns out to be economic nonsense. The overwhelming weight of economic analysis and evidence supports the conclusion that a country benefits from opening

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its own markets *regardless of what policies other countries choose to pursue.*

Free Trade Is Its Own Reward

The case for free trade at home can be embellished with all kinds of technical complexities, but in the end it boils down to common sense. It is now widely recognized that free markets are indispensable to our prosperity: when people are free to buy from, sell to, and invest in each other's markets as they choose, they are able to achieve far more than when governments attempt to control economic decisions. Given that fact, isn't it obvious that free markets work even better when we widen that circle in which we can buy, sell, and invest? Free trade is nothing more than the extension of free markets across political boundaries. The benefits of free trade are the benefits of *larger* free markets: by multiplying our potential business partners, we multiply the opportunities for creating wealth.

From this perspective, it becomes clear that Americans gain from open U.S. markets even when other countries are relatively closed.¹ The fact that people in other countries are not as free as they should be is no reason to restrict the freedom of Americans. When goods, services, and capital flow over U.S. borders without interference, Americans are able to take full advantage of the opportunities of the international marketplace. We can buy the best and cheapest goods and services the world has to offer; we can sell to the most promising markets; we can choose from the best investment opportunities; and we can tap into the worldwide pool of capital.

In particular, openness to foreign competition boosts American productivity and living standards in two basic ways. First, import penetration causes us to shift resources out of import-competing sectors in which we are relatively less productive and into exporting sectors in which we are relatively more productive. Thus, the workings of comparative advantage raise our nation's overall productivity by allowing us to concentrate on the things we do best.

Second, resistance to import penetration on the part of domestic suppliers causes them to reduce costs, improve quality, and otherwise increase productivity. Thus, even when foreign competitors do not succeed in expanding their market share, the spur of added competition that they provide sharpens the incentives to innovate here at home. For example, Americans today drive much better cars than we did 20 years ago, and not just because many drive imports; American

¹For a comprehensive argument for unilateral free trade, see Powell (1990).

cars are much better today, in large part because the U.S. auto industry was forced to compete at a higher level to stave off an onslaught of Japanese and European competition.

Thus, contrary to the logic of trade negotiations, countries should open their markets as a simple matter of national economic interest. The benefits that come from openness to foreign competition should not be rejected just because other countries insist on sticking with benighted and dysfunctional policies.

Many free traders are familiar with the theoretical case for unilateral liberalization. Nevertheless, they dismiss any alternative to international negotiations as politically impractical. It is widely assumed that countries will undergo the political pain of liberalization only if they get something in return—namely, improved market access abroad, and with it improved business opportunities for exporting firms. According to this view, which enjoys overwhelming acceptance in contemporary U.S. trade policy circles, trade negotiations may be based on economically questionable premises, but for free traders they are the only game in town. Furthermore, in this conventional conception, trade negotiations are dominated by considerations of reciprocity—that is, countries are motivated to liberalize not by the good it will do them, but by the quid pro quo they can win in return.

But this belief, however firmly entrenched, is demonstrably incorrect as a matter of historical fact. Not only *should* countries liberalize because it serves their national economic interest, but in the big picture that is precisely what they *do*.

Why Countries Liberalize

The past couple of decades have witnessed dramatic reductions in trade barriers around the world, and by and large these bold moves toward freer trade have occurred outside the context of trade negotiations. Countries as diverse as Australia, New Zealand, Argentina, Bolivia, Peru, Chile, the Philippines, Thailand, Indonesia, and India have decided unilaterally to forsake the old autarkic model of import substitution in favor of greater integration with the global economy. The driving force for sweeping change in those countries was not tough bargaining or the prospect of a quid pro quo, but rather the realization that protectionism was causing economic stagnation. In other words, protectionist countries have changed their policies to catch up economically with more open countries. When liberalization is unilateral, it goes without saying that considerations of reciprocity play no role; rather, the impetus for reform comes entirely from changing perceptions of national economic interest.

Even when liberalization occurs in the context of negotiations, it often fails to follow the reciprocity model. Consider the case of Mexico, our partner in the North American Free Trade Agreement: Mexico began dismantling protectionist policies on its own in the mid-1980s, and those initial unilateral reforms were actually far more sweeping than the additional reforms it promised under NAFTA. The NAFTA negotiations were then undertaken at Mexico's initiative, despite the fact that it still had more trade barriers than either the United States or Canada and thus relatively more to "give up" than to "gain" through negotiations. Mexico pushed for NAFTA primarily as a means to lock in prior unilateral reforms; the Salinas administration believed that it would be more difficult for future administrations to undo those reforms if they had been made a matter of international obligation. Here again, then, considerations of the national economic interest in liberalization were paramount.

A similar dynamic explains China's bold offer in 1999 of sweeping market-opening commitments in its World Trade Organization accession agreement with the United States. China has been officially seeking membership in the General Agreement on Tariffs and Trade and then WTO for 13 years, over which time negotiations dragged on and on with little progress. Then, suddenly, over the course of a few weeks, China agreed to almost everything the United States had been asking for. Why the change of heart? It seems clear that China's leadership came to the conclusion that a new round of market reforms was necessary to reverse the country's recently flagging economic performance; like Mexico in the NAFTA talks, China endeavored to use international negotiations to ram through needed domestic policy changes and then to insulate those changes from later reversal.

Of course, liberalization does occur as well through conventional reciprocity-driven swapping of "concessions." The point here, though, is this conventional model is not the only, or even the most important, path to liberalization. The real energy propelling liberalization around the world over the past couple of decades has been at the national level. When countries perceive that it is in their economic interest to open their markets, they do so—without especially worrying about what reciprocal offers of market-opening they will get in return. On the other hand, when countries do not believe that liberalization is needed, negotiations are doomed to achieve only marginal gains.

The conventional understanding of trade liberalization can be thought of as a "top-down" vision of international order. In this vision, the relatively open world trading system is imposed from above by international institutions and agreements. This interpretation, however, distorts why countries should liberalize their trade and why they

usually do. However at odds with received wisdom, a “bottom-up” vision of international order is actually much more consistent with both economics and political reality. According to the bottom-up view, the bedrock of the relatively liberal international trading system consists of national-level decisions that openness at home is in the national interest. Freedom of international exchange thus flows up from below as a necessary consequence of predominantly unilateral decisions at the national level.²

How Trade Talks Can Help

What then is the role for international negotiations and institutions in the bottom-up vision of trade liberalization? When appropriately structured and limited, trade agreements can play an important role in facilitating liberalization and especially in consolidating prior gains.

In the first place, linking liberalization at home with liberalization abroad can greatly strengthen the political prospects of dismantling domestic trade barriers. For one thing, the economic benefits of mutual liberalization are greater than those of unilateral liberalization. Although liberalization pays even if other countries remain protectionist, the payoff is richer still if other countries follow suit. Thus champions of international liberalization have a more appealing product to sell. Furthermore, although reforming protectionist policies brings economic benefits, it usually faces concerted political opposition from affected import-competing interests. If that lobbying pressure can be counteracted by the pro-trade lobbying, not just of import-using interests but also of exporting interests eager for improved access to foreign markets, then the chances of overcoming the opposition are enhanced considerably.

Probably the greatest assistance that international negotiations lend to trade liberalization, though, is in consolidating and institutionalizing prior gains. Once countries have decided to open their markets in the furtherance of their own national self-interest, those decisions can be harder to undo by subsequent protectionist-minded governments if liberalization has been enshrined as an international obligation. Thus, trade agreements can serve to “lock in” reforms by imposing additional political constraints on their reversal. Mexico’s pursuit of NAFTA, discussed earlier, was motivated primarily by precisely such considerations. Similarly, the recent defeat of legislation to impose quotas on U.S. steel imports was achieved largely on the ground that

²The distinction between liberalization “from above” and liberalization “from below” is made in Sally (1998).

such legislation amounted to a blatant violation of U.S. obligations under the WTO agreements.

Avoiding the Pitfalls of Reciprocity

Although trade negotiations can assist the process of liberalization, there are potential drawbacks as well. First, trade negotiations can actually undermine political support for open markets by fostering protectionist misconceptions and thus breeding a hostile political culture. As discussed previously, the conventional “reciprocity” model of trade talks is premised on the protectionist notion that imports are harmful and trade barriers are prized strategic assets. By following this model, trade negotiators and their supporters end up validating the very ideas that give rise to protectionist pressure in the first place.

Because of the reciprocity model, protectionist assumptions and attitudes color every aspect of how trade agreements are currently negotiated and evaluated. Trade negotiators, in the process of championing freer trade, insist that a “bad deal” (i.e., one in which we liberalize more than other countries do) is worse than no deal at all. They oppose domestic reforms outside the context of negotiations on the ground that our own bad policies are “bargaining chips” that should be retained for their exchange value. More ominously, they refer to liberalization without reciprocity as “unilateral disarmament.” And when an agreement has been reached, supporters focus on the benefits to exporters, not importers. They tout the benefits of reducing foreign trade barriers, but say little or nothing about the benefits of reducing our own.

By adopting the reciprocity model, free traders forfeit the opportunity to educate the public on the true benefits of open markets. That default was not especially important in the past when trade policy was hammered out in back rooms by experts and insiders. Now, however, trade issues engage the attention and passions of the broader public. And what the public sees in the often heated debates over trade policy is not a contest between true free traders and protectionists, but rather a disagreement between optimistic mercantilists and pessimistic mercantilists. The optimists, the supporters of trade liberalization, highlight the new export opportunities created by opening markets abroad; the pessimists dwell on the supposed threat of increased imports caused by opening markets here. Neither side, though, challenges the fallacious “exports good, imports bad” worldview.

Meanwhile, although free traders push optimism when they are trying to sell trade agreements, they unwittingly corroborate the pessimists’ fears when they are actually negotiating those deals. Thus, our

trade negotiators never tire of claiming that the U.S. market is the most open in the world. Of course, within the logic of trade negotiations, this is a sensible bargaining position, since it supports the conclusion that the United States should not have to “give in” on this or that issue. The American public, though, hears these claims and many conclude that the United States has been short-changed by past negotiations. Skepticism about future negotiations is therefore understandable. Similarly, U.S. trade negotiators complain incessantly about other countries’ trade barriers and their failure to live up to past agreements. Again, this line makes sense at the negotiating table, since it pressures our trade partners to make additional “concessions.” The American public hears these repeated complaints, though, and for many they confirm suspicions that the United States is always being out-negotiated or even cheated. Trade liberalization therefore looks like a losing proposition.

Trade policymakers can avoid these pitfalls by abandoning the old “reciprocity” model in favor of a new approach toward international negotiations. Under this new approach, policymakers would explicitly recognize what is in fact the case—namely, that open markets at home are the primary benefit of participating in trade agreements. Such a recognition would create an entirely different negotiating dynamic—it would replace haggling over reciprocity with “coordinated unilateralism.”

Unlike in reciprocity-based negotiations, the goal wouldn’t be to “win” at the bargaining table by “getting” more than you “give.” Rather, the express purpose of negotiations would be for each country to gain by reforming its own policies, but also to maximize that gain by linking reforms to liberalization abroad. Reforming one’s own policies would be a central negotiating objective rather than the downside of the transaction, while coordination would strengthen the political case for free trade by adding the benefits of liberalization abroad to those of market-opening at home.

Such an approach still leaves plenty of room for tough bargaining. Under coordinated unilateralism, however, the focus would be on the integrity of the overall agreement, not on any country-by-country tallying of “concessions” given and received. Specifically, the measure of success would be an agreement that reflects a serious international commitment to free-trade principles—as evidenced by the fact that a “critical mass” of countries has agreed to commit to some minimum threshold of liberalization. And in measuring the level of commitment of various countries, what matters is the extent of liberalization agreed to in the end; whether that end result is achieved through new reforms,

or simply through an agreement to “lock in” previously made unilateral reforms, should be irrelevant.

Under this approach, if there is not sufficient international interest in meaningful and significant commitments, then no agreement is reached. Countries are then free to continue to liberalize unilaterally. Going it alone will not mean a loss of “bargaining chips” or leverage in subsequent negotiations; if such negotiations do occur in the future, countries will receive full “credit” for any liberalization achieved in the interim.

Although coordinated unilateralism would represent a sharp break from the current rhetoric of trade talks, diverging from current practice would be much less dramatic. In a study of the Uruguay Round negotiations, J. Michael Finger of the World Bank found that the reciprocity model does a very poor job of explaining what actually happened.³ That model would predict that countries’ “net concessions” should be close to zero; in fact, however, an analysis of the tariff commitments of 33 countries shows that net concessions varied dramatically from country to country. Meanwhile, interviews with 10 different negotiating delegations found none that had actually tallied concessions given versus received (either within the tariff negotiations specifically or across the range of all Uruguay Round agreements). There was broad agreement, however, about the importance of ensuring that each country made an “appropriate contribution” to tariff cutting. In this regard, Finger found that countries did receive “credit” for prior unilateral cuts when they agreed to bind their rates at the currently applied levels.

In addition, the coordinated unilateralism model fits very well with the record of the post-Uruguay Round sectoral negotiations—the Information Technology Agreement and the agreements on telecommunications and financial services. For all three agreements the challenge was to enlist a critical mass of countries to agree to particular liberalization thresholds. In all of these talks, the United States exercised significant leverage despite the fact that it already had a zero tariff rate for semiconductors and offered only to lock in current levels of openness in telecommunications and financial services. The lock-in by itself was considered a valuable U.S. contribution by other countries; furthermore, U.S. participation in the agreements gave them legitimacy and thus bolstered other countries’ confidence in each other’s commitments. Using its leverage, the United States walked away from the financial services talks when it was dissatisfied

³“Market Access Bargaining in the Uruguay Round: Rigid or Relaxed Reciprocity?” is discussed in Bhagwati (forthcoming).

with some of the offers from key participants; in the end negotiations resumed and a stronger package of commitments was achieved.

So how would coordinated unilateralism differ from the status quo? The difference would be primarily rhetorical, not substantive. But in politics rhetorical changes can be extremely important. In the present case, a shift to coordinated unilateralism would allow trade policymakers to continue to reap the political advantages of international liberalization without at the same time salting the earth with protectionist nonsense.

Keeping Negotiations on Track

The other major problem with trade negotiations, besides their mercantilist assumptions, is that they can veer off in the wrong direction. Instead of reducing government interference in trade and investment flows, misguided international agreements can actually increase such interference. This risk has grown in line with the increasingly ambitious scope of trade negotiations.

The original focus of trade agreements was on border measures that discriminate overtly against foreign goods—namely, tariffs and quantitative restrictions. Over time, though, as tariff levels have fallen and import quotas have been relaxed and eliminated, the scope of trade negotiations has expanded to address nontariff barriers—that is, domestic policies that discriminate against or simply inhibit international commerce. Thus, such areas as product standards, food safety regulation, subsidies, and intellectual property protection have been swept within the purview of trade policy.

As the reach of trade agreements into domestic policy has extended, it has become increasingly plausible to argue that any policy area that “affects” trade—and practically every public policy has some effect on trade—deserves to be included on the trade agenda. In particular, those who call for negotiating international labor and environmental agreements through the WTO are able to make a seductive argument: If the WTO requires national governments to protect the intellectual property rights of software companies and pharmaceutical manufacturers, why shouldn’t it require, or at least allow, national governments to protect the environment or the rights of workers? Are these objectives somehow less valuable than the profits of multinational companies?

If such thinking carries the day, there is a serious risk that future trade negotiations will end up doing more harm than good. First, they could create broad new exceptions that allow national governments to close their markets out of social policy considerations—for example,

restricting imports from countries that do not guarantee a particular minimum wage or that do require certain air quality standards. Alternatively, trade agreements could impose ill-considered new international regulatory requirements on national governments, compliance with which would then be enforceable through the WTO dispute settlement process.

Such unfortunate developments can be resisted effectively only if free traders remember what makes trade negotiations worth pursuing in the first place. Trade agreements are beneficial insofar as they facilitate the opening up of national markets to foreign competition. If they subvert that objective—whether by conferring international legitimacy on new forms of protectionism or by saddling the world with a new layer of international regulatory bureaucracy—they deserve the opposition, not the support, of believers in free trade.

The risk that trade agreements will wind up increasing rather than decreasing government interference in international markets is heightened considerably by the currently dominant top-down vision of international order. People who believe that a global economy requires a global rule-making body will naturally sympathize with extending the WTO's mandate into any area of plausibly international concern—even when such extension conflicts with the original market-opening purpose of the organization. Even more committed free traders who do not welcome WTO “mission creep” will be influenced to compromise by the top-down viewpoint. To the extent that they believe the world trading system is completely dependent on international negotiations and institutions, they are correspondingly more likely to give in to demands to expand the trade agenda in illiberal directions if that is the only apparent way to keep the “process” moving forward. Just in the past year or so, in the wake of the multiple failures of fast track legislation and then the debacle in Seattle, there has been increasing pressure within elements of the U.S. free-trade camp to make concessions on environmental and labor issues.

From the bottom-up perspective, on the other hand, it is clear that liberalization can proceed if need be without international negotiations—and indeed would be much better off without them if they become infected by anti-market initiatives. Those free-traders who counsel appeasement of environmental and labor activists cite the “bicycle theory” of trade negotiations, according to which the process must either keep moving forward or else collapse into protectionism and conflict.⁴ But as trade economist Jagdish Bhagwati has responded, it may be better to fall off the bicycle than to keep pedaling in the

⁴The “bicycle theory” is discussed in Destler (1995: 17–18).

wrong direction. And in the end, a credible willingness to accept no agreement rather than a bad agreement may be the best guarantor of avoiding a wrong turn.

Conclusion

The case for trade negotiations from the free-trade perspective is more nuanced than is commonly understood. Negotiations are not required for trade liberalization to occur; after all, the most dramatic progress in market-opening over the past couple of decades has occurred through unilateral reforms at the national level. Furthermore, negotiations, if conducted incorrectly, can actually undermine the free-trade cause.

When structured properly, though, international trade agreements can provide a useful supplement to purely unilateral liberalization. Such agreements can help overcome political obstacles that hinder the opening of markets; also, they can consolidate market-opening gains and make them harder to reverse. The key to maximizing negotiated liberalization's advantages, and avoiding its pitfalls, is found in the bottom-up vision of international economic order. That vision recognizes that countries should and do open their markets largely on the basis of perceived national economic interest. Accordingly, the proper model for trade negotiations is not mercantilist-minded "reciprocity" but rather "coordinated unilateralism."

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THE LIMITED BUT IMPORTANT ROLE OF THE WTO

William H. Lash III

The World Trade Organization is in many ways similar to the splitting of the atom. Both have great potential for productivity and destruction. The limited role of the WTO is that it cannot save us from us. The WTO cannot establish new values or agendas for future trade officials. The scope and future of the WTO are limited by the vision, imagination, courage, and conscience of the trade community.

The WTO's goal and function are to remove tariff and nontariff barriers and provide a mechanism for solving disputes between member states. However, the WTO has limits. Two of the forces forming these limits are consensus and expertise. Consensus is still the watchword for the WTO. Consensus has had a positive impact on restraining those who would turn the WTO into an economic sanctions-granting version of the United Nations, and consensus keeps the membership focused on the serious business of trade. Expertise and the recognition of the limits of the areas of expertise is another limiting force on the WTO.

The General Agreement on Tariffs and Trade was also limited in addressing many areas of the global economy or addressed them only on a piecemeal basis. The old version of the GATT created limited, a la carte agreements on government procurement and subsidies and engaged only a limited number of parties. The WTO has improved upon the GATT regime and now addresses agriculture, investment, services, and intellectual property. Not bad for only 50 years of work.

The WTO is not like the old *Ed Sullivan Show*. It does not have an act to please every audience. Since its inception, efforts have been made to hijack the train of trade in the name of the environment,

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labor, global ethics, and sovereignty. Why are these new trade-comelatelies coming to the WTO to pursue their agenda? For the same reason Willie Sutton robbed banks: 'cause that's where the money is. If these "trade terrorists" cannot gain control at the WTO, they would just as soon destroy it. The protests and massive disruptions of traffic in Seattle illustrated that these demonstrators are more interested in press coverage than meaningful debate and dialogue.

Rules on international trade are highly developed, reflecting 50 years of GATT/WTO negotiations. In the multilateral trading system, the environment, labor, and competition policy are new factors that threaten to burden the WTO. Newer areas of trade should properly be studied and addressed at the WTO. But the goal of studying these issues should be to remove barriers, not create new trade barriers. Those who advocate linking trade and labor or the environment at the WTO are not interested in promoting world trade. They are interested in the leverage of trade to promote their often statist views. They seek not the spirit of the WTO but its perceived power and prestige.

The answer the detractors seek is usually trade sanctions. According to them, we should not trade with states that have environmental or labor standards that differ from those of the United States or the European Union. They believe the WTO should establish minimum standards in these and other areas. States failing to meet these standards could be hit with either countervailing duties or trade sanctions.

Coming up with new reasons to block trade is not the spirit or intent of the WTO. Denying access to the U.S. market because of our environmental or labor values opens the floodgates to a host of morality-driven trade restrictions, jeopardizing the multilateral trading framework. In addition, we must recognize that the trade principle of division of labor should apply to the choice of forum. Although well suited to handle trade disputes, the WTO is primarily a trade forum and lacks expertise in assessing environmental or labor standards. The United Nations should continue to address global environmental issues. Similarly, the International Labor Organization, a long-standing body of labor, states, and firms, is best suited to handle labor concerns. Issues such as competition policy and corporate conduct belong in the Organization for Economic Cooperation and Development, not the WTO. To allow the WTO to become saddled with these issues would be inefficient. Relying on nongovernmental organizations (NGOs) such as Greenpeace to set standards would also thwart global trade. Governments and environmental NGOs for whom trade is not a primary goal are unlikely to take a balanced perspective when evaluating trade and the environment.

Dispute settlement is what the WTO does best. Trade disputes are brought before the WTO at approximately three times the rate that had typically been handled by the GATT. In the past four years, the United States has been the greatest proponent of this system. Approximately 40 cases have been brought by the United States seeking compliance with trade agreements and market access. The United States has had a good deal of success in this forum, winning a large majority of its cases. U.S. trade advocates have gained market access in areas ranging from agriculture to information technologies. In contrast, the WTO's predecessor, the GATT, often derided as the "Gentleman's Agreement to Talk and Talk," failed to resolve many disputes and lacked credibility as a mechanism for resolving trade disputes. Parties to a GATT dispute could simply reject and block acceptance of the panel report. The case could be reargued numerous times until the parties tired of it and an agreement was reached.

The definition of winning and losing at the WTO departs from the traditional notion of victory. If the WTO supports the United States in a market-opening initiative, the United States wins. In other cases, victory may come from the pressure that follows initiation of an action. Many of our trading partners, mindful of the significance of a WTO decision and not willing to be viewed as protectionists, settle the disputes before the case is adjudicated. The newest WTO enforcement provisions have been useful in gaining favorable results short of the courthouse door. Of the approximately 120 disputes brought before the WTO, one quarter have been settled before WTO panel decisions. At the risk of sounding like a Zen master, I submit we can also win by losing at the WTO. The United States is the most often named defendant in WTO disputes. WTO panels provide an opportunity to test U.S. practices and laws to see if the United States is truly an open economy, dedicated to free trade. An examination of our policies by impartial panels of experts tests the validity of many laws and evaluates how we may be engaging in market-distorting activities while preaching free trade to others.

Another limit of the WTO involves the limits of its power. Contrary to all those who bemoan the surrender of sovereignty to the WTO, we must bear in mind that the WTO does not have the power it is perceived as having. First and foremost, we must recognize that the WTO has no enforcement powers. The WTO cannot rewrite U.S. laws or levy taxes on violators. Leading constitutional law scholars have joined in debunking the notion of a powerful WTO. Former U.S. Court of Appeals Circuit Judge Robert H. Bork, the eminent U.S. constitutional law scholar, has concluded that the sovereignty

issue “is merely a scarecrow.” Under our constitutional system, he says, “No treaty or international agreement can bind the United States if it does not wish to be bound. Congress may at any time override such an agreement or any provision of it by statute” (quoted in Kantor 1996). Professor John H. Jackson of Georgetown University School of Law, perhaps the nation’s leading GATT expert, joins in dismissing the sovereignty claims as “ludicrous.” Professor Jackson concludes that the WTO “has no more real power than that which existed for the GATT under the previous agreements” (Jackson 1994).

The confusion over the power of the WTO system stems from a flawed understanding of U.S. power under the old GATT system. Traditionally, under the GATT states could veto decisions of dispute panels. Historically, this power of a state to block acceptance of a GATT ruling was popular when a decision went against the United States, but less so when the United States was the complaining party. As a leading plaintiff in WTO complaints, the United States has a substantial interest in seeing that the determinations of dispute settlement panels are accepted.

The WTO dispute resolution mechanism is still based on the old GATT principles of negotiation, conciliation, mediation, and arbitration. If this mechanism is unsuccessful, an impartial panel hears the case and renders a finding. If the measure in question is found to be inconsistent with WTO rules, the offending state has the option of changing the WTO-inconsistent measure or offering trade compensation in the form of lower tariffs or increased market access to the aggrieved nation. In the unlikely event that the parties cannot come to any agreement at this stage, the complaining party may take retaliatory measures equal to the amount of the offending action against the offending nation. This action would have the approval of the WTO. The dispute settlement system of the WTO is intended to provide “security and predictability” to the entire multilateral trading system.

The dispute settlement mechanism has limits that have been challenged by WTO members. The U.S.-Japan film distribution dispute was not a pure market-access dispute. The United States attempted to challenge the antitrust laws and enforcement of these laws by Japan. The WTO panel correctly recognized that competition policy is not subject to WTO review. Most important, the WTO did not accept the claims of nonviolation and nullification asserted by the United States. Such an interpretation could leave a host of domestic laws subject to WTO challenge. It is significant to note that the parties did not appeal the decision and Japan announced plans to amend some of the challenged laws. In summary, the system worked. Japan’s

laws were scrutinized by the world, and the Japanese voluntarily decided to make changes. Each side gained.

We have seen WTO disputes with the European Union spill over into street fights. This reflects another limit of the WTO. WTO dispute settlement procedures are designed to produce consensus, not additional disputes or trade tension. At any point in the dispute settlement process, the parties are free to mediate a resolution to the dispute. The only sanction under the WTO process is the suspension of WTO trade-agreement-based concessions against the offending country. Under the WTO agreement, this relief should be requested only as a last resort.

Unfortunately, in recent disputes the United States has been forced to retaliate against valued trading partners. I am not an advocate of trade sanctions, but to preserve the integrity of the WTO both at home and abroad we have had to impose sanctions on the European Union. If we failed to impose sanctions, WTO critics around the world could rightly say that the GATT was back. To quote Napoleon, "It is better to kill one thousand and appear harsh than to appear to be too lenient and then have to kill ten thousand as a result of that first mistake." WTO-sanctioned trade retaliation is a second-best option.

The old time-honored GATT rule of consensus has not disappeared. Parties are bound to accept panel or appellate body reports. But bound does not mean the WTO can or will enforce the decision. Enforcement is a coercive act, and the United States has not agreed to surrender sovereignty to the WTO or any other body.

One case often mentioned to illustrate that the WTO weakens U.S. sovereignty is the first case decided by a WTO panel—a case involving U.S. Environmental Protection Agency rules on imported gasoline. This case, brought by Venezuela and Brazil, challenged EPA regulations on reformulated gasoline which require that imported fuel quality be pegged to a 1990 U.S. baseline standard rather than to individual refinery baselines. Venezuela asserted that the guidelines placed imports at a disadvantage in U.S. markets. The WTO panel agreed that the U.S. gasoline regulations discriminated against foreign refiners.

In this early test of compliance with WTO reports, the EPA issued new pollution rules for imported gasoline. Pursuant to the new regulations, foreign refiners will have more flexibility in meeting the overall guidelines for reducing pollution-causing chemicals in conventional gasoline and will be allowed to maintain the same level of pollutants as U.S.-refined gas. The EPA did not change the U.S. rules on cleaner-burning "reformulated" gas despite a determination by the WTO that the rules were similarly discriminatory. Because the reformulated gas rules expired at the end of 1997, the EPA had no need to rewrite

the rules. The United States took 15 months to carry out that partial implementation. There was no threat to U.S. environmental standards in this case.

Similar environmental concerns have been raised in the WTO shrimp-turtle dispute. Here, U.S. environmental regulations prohibited the importation of shrimp harvested without sea turtle excluder devices. The WTO found that the United States had the legal right to engage in conservation measures to protect wildlife under Article XX of the GATT, the WTO's charter. But the WTO Dispute Panel concluded that the method employed was arbitrary, was not the least trade-restrictive, and constituted "in effect an economic embargo."

The shrimp-turtle case has changed the way we view environmental trade disputes at the WTO. The appellate review of the case opens the door for more environmental issues to be decided before the WTO and with more involvement by NGOs. Several NGOs filed amicus briefs with the WTO, further politicizing the dispute process.

The WTO has been accused of weakening or threatening U.S. national security. Trade disputes with the European Union have been raised due to the Helms-Burton Act. The Helms-Burton law calls for a variety of sanctions against companies that have purchased property in Cuba that was stolen from its rightful pre-Castro owners. Even though the act is economically unsound and frankly does not enhance national security, a WTO panel would not undermine the act. Article XXI of the GATT acknowledges each member's right to act as it deems necessary for the protection of its essential security interests in time of war or other international emergency.

Helms-Burton is legal and would survive WTO review. Article XXI explicitly recognizes that countries can act unilaterally in the name of essential security. But it declines to define exactly what constitutes essential security. In an earlier dispute involving U.S. export restrictions on Czechoslovakia, the GATT determined that each country is the final judge on questions relating to its own security. WTO members have recognized this principle for over 35 years, and that a country's security interest may be threatened by a potential as well as actual danger. Similarly, in 1985, our embargo on Nicaragua relied on the GATT security exception. The trade community accepted this—and so did the International Court of Justice.

The WTO cannot solve all of our ills. It cannot grow hair, bring about world peace, or whiten your smile. But the economic prosperity of a stable multilateral framework can improve the standards of living around the globe.

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PROSPECTS FOR NEW WTO TRADE NEGOTIATIONS

Jeffrey J. Schott

Trade ministers from the 135 member countries of the World Trade Organization met in Seattle in early December 1999 but failed in their efforts to launch a new round of multilateral trade negotiations. To be sure, the violent protests complicated their task. More important, however, the ministers were unable to bridge major differences both among developed countries and between developed and developing countries regarding what should be on the agenda of the new WTO Round.

In large measure, the developed countries were reluctant to address their own barriers to trade in goods and services but demanded that the new talks target protectionism in developing countries. For their part, developing countries argued that new concessions should await the fulfillment of the Uruguay Round reforms by developed countries (especially regarding textiles, compliance with dispute rulings, and “best efforts” commitments to encourage technology transfer).

Everyone seemed to want the Uruguay Round accords to be faithfully implemented, but developed countries talked about adhering to the new trade rules, for example, deadlines for Trade-Related Aspects of Intellectual Property and Trade-Related Investment Measures, while developing countries focused on commitments to liberalize trade barriers (in particular, U.S. and European Union commitments to eliminate textile quotas and their “alleged” efforts to undercut market-access commitments with anti-dumping measures).

Everyone wanted to expand the WTO agenda beyond the issues mandated by the Uruguay Round accords (the so-called “built-in” agenda), but countries differed markedly on which new subjects

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deserved priority. The United States, for example, pushed for new WTO initiatives on electronic commerce and on trade-related labor issues; the European Union wanted more attention given to investment and competition policy issues. By contrast, developing countries wanted to focus efforts on more traditional issues such as tariffs and agricultural restrictions. In services, developing countries placed priority on removing barriers in sectors in which they are competitive such as labor, maritime, and entertainment services; developed countries favored their own “winners” such as financial, air transport, information, and professional services. “Priorities” of some countries were “nonstarters” for others.

The chief example of these conflicting interests involved U.S. efforts to establish a new WTO Working Group on Trade and Labor. In the aftermath of the China WTO deal, U.S. negotiators were under great pressure to secure agreement on their proposal to open a WTO forum on these issues. To be sure, the U.S. proposal was much more modest in this area than earlier U.S. initiatives that were soundly rebuffed by most other WTO members. But opposition from developing countries remained intractable. It is hard to conceive of their changing course unless the United States responds more favorably to issues of priority concern to developing countries in the negotiations.

Lest one think that all of the problems fell along a North-South divide, it is important to emphasize that one of the biggest hurdles to a successful meeting in Seattle involved substantive differences on numerous issues among the Quad countries (United States, European Union, Japan, and Canada). The United States wanted deeper cuts than Europe or Japan in farm subsidies and tariffs, but opposed those countries’ demands for new talks on investment and competition policy. Japan wanted to reexamine anti-dumping provisions, and Europe and Canada wanted to explore cultural exemptions, both of which conflicted with U.S. proposals. The end result: a leadership vacuum at the heart of the trading system.

Crafting a Workable Agenda

Given the failure in Seattle, what options do WTO members have in crafting a workable agenda for new trade negotiations?

First, they could rely primarily on existing mandates and possibly supplement them with new initiatives during the course of the negotiations (as was done in both the Tokyo and Uruguay Rounds). Under the WTO’s built-in agenda, negotiations on agriculture and services were launched in early 2000. Unfortunately, the experience under the General Agreement on Tariffs and Trade (GATT) demonstrates

that self-standing negotiations on agriculture never succeed; recent services accords have fared somewhat better (but only when developing countries accepted deals that did not require significant changes in U.S. and European practices). A broader bargain will be needed to enable countries to trade off concessions across sectors and issues and undertake obligations to liberalize long-standing and politically sensitive trade barriers.

Second, they could follow the current U.S. approach—which seeks to limit the negotiating agenda by focusing primarily on sector and product-specific reforms, and not on revising the terms of the Uruguay Round accords to avoid protracted negotiations. Here again, the proposed U.S. agenda does not encompass a “critical mass” of issues to ensure that agreements can be reached that accommodate the diverse interests of the developed and developing countries. We want tariff reforms (but not our tariff peaks); we want farm trade liberalization (but not in sugar and dairy); we want services reform (but not in maritime and nonprofessional services); we want to negotiate new WTO obligations in some areas like labor but not in others like anti-dumping. I do not believe that the United States expects to be a “free rider” in the new round, but we will have to be willing to reform some of our existing trade barriers and restrictive practices if we want other WTO members to sign on to the much more substantial reforms that we demand.

To take into account the diverse perspectives of WTO member countries, new talks will have to encompass a broad range of issues. New WTO negotiations thus will have to pursue several initiatives simultaneously:

- Trade liberalization in industry and agriculture and in developed and developing country markets
- New rule-making that establishes rights and obligations in areas not yet subject to, or inadequately covered by, WTO provisions
- Institutional reforms that remedy flaws in the WTO’s dispute settlement procedures, that make WTO operations more transparent, and that help promote economic development for the betterment of all citizens of WTO member countries

To be sure, some trade officials worry that WTO talks will bog down if negotiators cover too many issues, including subjects that do not seem “ripe” for resolution in the near future. They fear that the requirement that the new round be a “single undertaking”—in which nothing is agreed on until all aspects of the package of accords are agreed on—would make concluding new trade pacts promptly quite

difficult because negotiations in some areas will require many years to be fully resolved.

A Round-up of Agreements

Unfortunately, many trade officials still think of new WTO talks as a fixed-length, one-shot GATT round, even though they admit that the old GATT approach no longer fits the fast-paced world of global commerce. Instead, they should adopt a broader, yet more pragmatic, strategy for trade negotiations.

Fortunately, the WTO has already upgraded the GATT model; its new institutional framework accommodates continuous negotiations. WTO ministers can start and finish talks on some issues while other subjects remain under debate and new issues are added to the agenda. Trade ministers could use their regularly scheduled meetings as action-forcing events to put together a package of trade agreements in what I have called a “round-up” (see Schott 1998). In this way, countries can conduct a series of seamless trade negotiations, with new talks starting immediately after a package of trade agreements is concluded. Each round-up would build on the results of the previous accord. Over a decade, the WTO could produce three or four round-ups, which cumulatively liberalize significant trade barriers and strengthen a member country’s rights and obligations.

Each round-up or set of agreements would be a single undertaking but would not require that all aspects of all issues under negotiation be completed before a deal could be concluded. Because the WTO is a forum for continuing negotiations, not all of the problems in a given sector need to be resolved in the first phase of talks or the initial round-up, nor would each round-up have to include all issues. Each package, however, would have to include reforms of interest to both developed and developing countries, so that each member could “bring home” concessions that reinforce domestic political support for the trade pacts and for implementing reforms of their own trade barriers.

To be sure, such an approach still requires complicated horse trading among a large number of countries on a large number of issues. But crafting such packages of agreements, I believe, is essential to accommodate trade-offs across sectors and issues, involving both product- or sector-specific liberalization and acceptance of new trade obligations. Without such grand bargains (even on the more limited scale envisaged by my round-ups), WTO members will likely fail to dent the strongest trade barriers protecting domestic industries in their key export markets.

In that regard, the three-year timetable for the WTO talks, as proposed by the United States and others, will clearly be ambitious, especially if the lack of fast track and electoral politics in 2000 limit the flexibility of U.S. negotiators to address politically sensitive U.S. trade barriers until well into 2001. Under such a scenario, WTO talks probably can't be launched until late 2001 and surely can't be concluded three years hence during the 2004 election campaign.

A Need for U.S. Leadership

So what should the United States do? Simply put, the United States has to exert a more positive leadership role in the negotiations. The United States has broad-based economic and political interests in a successful WTO Round. Most of its objectives involve liberalizing foreign trade barriers down to U.S. levels and strengthening WTO rules so that foreign trade laws and regulations move up toward U.S. norms.

But the United States will also have to contribute to the party. Although the U.S. market is arguably the most open in the world, there are a few notable barriers whose partial liberalization could yield large dividends in both foreign trade concessions and U.S. economic welfare, such as reductions in peak tariffs (including textiles and clothing), perhaps capped at a level of 15 percent or below; reductions in agricultural protection, including cuts in domestic subsidies and enlargement of tariff-rate quotas on sugar, citrus, and dairy products; increased de minimis thresholds for the application of anti-dumping duties; and new guidelines on the provision of temporary labor services by professional and other workers.

The United States is the leader of the world trading system, and it must lead by example.

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THE ELUSIVE GOAL OF AGRICULTURAL TRADE REFORM

Kym Anderson and Paul Morris

The Uruguay Round Agreement on Agriculture represented a significant achievement because for the first time, a comprehensive set of disciplines was placed on trade-distorting measures affecting agricultural products. The negotiations applied limits to and cuts in both export subsidies and market access barriers, while recognizing that domestic support measures can also distort trade. The Agreement on Agriculture served to both define the problem and place some loose bounds around it. More than that, the Agreement on Agriculture altered the climate of farm policymaking in both advanced and developing countries, and raised the consciousness of policymakers on the international implications of their actions.

However, although agriculture was included in the multilateral framework for trade, it was not fully integrated into that framework. The Agreement on Agriculture applies a set of rules and disciplines that are different from those applied to trade in other goods and has resulted in the continuation of much higher levels of assistance for agriculture (particularly for processed food products) than for other goods. Indeed, little reduction in agricultural protection will have occurred by the end of the implementation period (2000 for developed countries and 2004 for developing countries). It is notable that, in 1998, agricultural support by the Organization for Economic Cooperation and Development (OECD) countries totaled some \$362 billion—\$36 billion higher than at the start of the Uruguay Round. Moreover, market access barriers in the primary agricultural sector and the processed food sector tend to be much higher than for other sectors. Such differences in protection between sectors result in severe distor-

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tions to the efficiency of resource allocation both within and between countries.

The first part of this article discusses the significant gains to World Trade Organization member countries that could come from further liberalization in agriculture to reduce or remove such distortions. The second part outlines the objectives of the Cairns Group in the next round, based on the eventual integration of agriculture into the normal WTO rules and disciplines applying to trade in other goods.

The Potential Gains from Further Agricultural Policy Reform

The Uruguay Round (UR) is scheduled to be fully implemented in all sectors and regions by 2005. At that time, the potential will exist for further significant gains from reforming agricultural markets. Roberts et al. (1999) recently estimated that a further 36 percent reduction in agricultural support beyond that achieved in the Uruguay Round would result in gains in global welfare of around \$34 billion a year. We present results of a recent study by Anderson, Hoekman, and Strutt (1999) in which the gains from liberalization of the agricultural sector are placed in the broader context of gains from liberalization in all traded goods sectors. Some focus is also given to gains by developing countries relative to those achievable by OECD countries. The study makes use of a modification of the global economy-wide model known as GTAP (Global Trade Analysis Project), focusing only on traditional trade policy instruments: tariffs, quotas, and subsidies. It examines the benefits that could be attained from complete liberalization of goods trade barriers after all the gains from the Uruguay Round have been achieved in 2005. The study does not include the benefits of reform to the services sector and therefore underestimates the total gains that are achievable for a broader liberalization of trade in all goods and services.

The projected extent of distortions to goods markets that will remain in 2005, assuming the Uruguay Round is fully implemented and China and Taiwan have joined the WTO by then, is highly skewed. Despite the UR agreements on farm and textile products, their protection rates will still be high in 2005, especially for the agricultural and processed food sectors. Globally, the farm and food sector will have twice the import tariff average of textiles and clothing and nearly four times that for other manufactures. Significant distortions to farm production and trade thus will still be in place if no further policy reforms occur. The cross-regional pattern of distortions will then

continue, with OECD countries subsidizing, and developing countries taxing, farm production and exports.

The High Cost of Agricultural Protection

In the study by Anderson, Hoekman, and Strutt, six alternative scenarios are compared with the base scenario of the GTAP model's projection of the world economy in 2005, post-Uruguay Round. In these scenarios, all OECD countries are assumed to have removed all price and trade distortions to (1) agriculture and processed food, (2) textiles and clothing, (3) other manufacturing, and (4) all goods combined. In two subsequent scenarios (5) all developing economies remove all price and trade distortions to their goods markets, and (6) OECD and developing economies together remove all price and trade distortions to their goods markets.

If both OECD and developing countries were to liberalize all of their goods markets in 2005, the model results suggest that global welfare would be greater by \$260 billion per year. This is a gross underestimate of the aggregate gains from trade liberalization because services and government procurement policies are excluded. No account is taken of the benefits of increasing the degree of competition and the scope for scale economies. A high degree of regional and product aggregation is employed. And the dynamic effects of reform are not captured. However, those omissions may not greatly affect the relative gains from reforming the various markets for goods, so that is what we focus on below.

Almost one-third (32 percent) of the estimated global gains from goods trade liberalization would come from agricultural reform in OECD countries—even though farmers in those countries contribute only 4 percent of global gross domestic product and less than 10 percent of world trade. That amounts to gains of over \$80 billion a year. Textiles and clothing reforms appear to pale by comparison with farm reform: their potential global welfare contribution is only one-eleventh that of agriculture's. That big difference reflects the fact that distortions to prices for agriculture are more than twice those for textiles and clothing and that textiles and clothing contribute only 1.5 percent to the value of world production and 5.5 percent to the value of world trade, half or less the shares for farm products.

However, the foregoing two assumptions also contribute to this result. One is the assumption that China and Taiwan will join the WTO before 2005 and enjoy the same accelerated access to OECD markets under the UR Agreement on Textiles and Clothing as other developing countries that already are WTO members. The other cru-

cial assumption is that OECD countries will fully implement the ATC. The latter is far from certain to happen though, particularly if China joins WTO soon and phases out its voluntary export restraints on textiles and clothing by 2005. Dropping either of those assumptions reduces very substantially the estimated gains from UR implementation (Anderson et al. 1997), and therefore raises the potential gains from textile and clothing reform in the next WTO round.

Even so, agricultural protection would remain much more costly to the world economy than barriers to textiles and clothing trade—and more costly even than protection to other manufactures, despite other manufacturers having much bigger shares in the value of world production and trade than farm products. WTO members were right, therefore, to insist that agricultural reform must continue into the new century without a pause.

Developing countries in particular have a major stake in continuing the process of farm policy reform. According to the model's results, the farm policies of OECD countries contribute 42 percent of the cost of global trade distortions to developing economies, nearly as much as their own trade-distortionary policies. OECD textiles and clothing policies also harm developing countries greatly, but only half as much as OECD farm policies. OECD barriers to imports of "Other manufactures," by contrast, actually help developing economies. The reason is that those trade restrictions lower international prices of those products (that developing countries import), thereby improving the terms of trade of developing countries.

For the OECD economies, despite the fact that agriculture and food represent only about 5 percent of their gross domestic product, abolishing their remaining agricultural protection in 2005 would contribute one-quarter of their welfare gains from liberalizing all goods trade globally—and nearly two-fifths of the gains from liberalizing trade in all goods in the OECD alone.

The Struggle for Agricultural Trade Reform

Although there has been a substantial body of research over many years estimating the benefits of farm and other trade liberalization (see, e.g., Tyers and Anderson 1992), it has proved difficult to achieve the substantial reductions in agricultural support necessary to achieve these gains. In this section, we outline the objectives of the Cairns Group of countries for the agricultural trade talks mandated by the "built-in" agenda to begin in the year 2000. The Cairns Group of agricultural exporting countries was formed in 1986 to influence agricultural negotiations within the WTO. The 15 members of the

Cairns Group in 1999 were Argentina, Australia, Brazil, Canada, Chile, Colombia, Fiji, Indonesia, Malaysia, New Zealand, Paraguay, the Philippines, South Africa, Thailand, and Uruguay. These countries account for around 20 percent of world trade in agricultural products. The group's efforts contributed substantially to establishing a framework for reform in agriculture in the Uruguay Round. By acting collectively, this disparate group has had more influence and impact on the agriculture negotiations than any individual members would have had independently.

Trade ministers from the Cairns Group countries met in 1998 and 1999 with the objective of positioning the group to play an important role in the new round of WTO agricultural negotiations. Most recently, from August 27–29, 1999, the ministers met in Buenos Aires, Argentina, where they produced a communique that reaffirmed their previously released “vision statement” for the next negotiations and highlighted the Cairns Group's views on other issues.

The vision statement conveys the group's ambitious objectives for the 1999 agriculture negotiations, with the overarching principle being the integration of agriculture into the rules and disciplines that apply to other products—specifically, to reduce the disparities that were highlighted as so costly in the previous section. As stated by the Cairns Group ministers in April 1998,

The Cairns Group of Agricultural Fair Traders reaffirms its commitment to achieving a fair and market-oriented agricultural trading system as sought by the Agreement on Agriculture. To this end, the Cairns Group is united in its resolve to ensure that the next WTO agriculture negotiations achieve fundamental reform which will put trade in agricultural goods on the same basis as trade in other goods. All trade-distorting subsidies must be eliminated and market access must be substantially improved so that agricultural trade can proceed on the basis of market forces.

In addition, the group indicated support in an August 1999 communique for “clear and detailed decisions in Seattle to ensure agriculture negotiations begin on time, conclude before 2003, and have an explicit negotiating timetable to deliver required outcomes.” The vision statement outlined the Cairns Group's reform goals in three key reform areas within the UR framework: export subsidies, market access, and domestic supports.

On export subsidies, the fact that (often discriminatory) farm export subsidies are still tolerated continues to distinguish agricultural from industrial goods in the General Agreement on Tariffs and Trade—a distinction that stems from the 1950s when the United States insisted on a waiver for agriculture of the prohibition of export subsidies. The

Cairns Group's objective in this area is that all export subsidies be made illegal for agricultural products, as they are for other traded goods, and that clear rules be established to prevent circumvention of export subsidy commitments. In this regard it is worth noting that only 25 of the 135 current WTO members are entitled to use export subsidies and most of these are developed countries (with more than 80 percent of export subsidies accounted for by the European Union). Under the Agreement on Agriculture from the Uruguay Round, budgetary expenditure on export subsidies is to be lowered by 36 percent from the base period, while the volume of subsidized exports is to be reduced by 21 percent (and only 14 percent for developing countries).

Moreover, subsidized export credits were not included within the reduction commitments, despite their having a similar effect to direct subsidies in improving the competitiveness of a country's exports. However, there was a requirement that further negotiations take place to develop disciplines on export credits, specifically that "Members undertake to work toward the development of internationally agreed disciplines to govern the provision of export credits, export credit guarantees or insurance programmes and, after agreement on such disciplines, to provide export credits, export credit guarantees or insurance programmes only in conformity therewith" (Article 10(2)). These negotiations have been taking place within the OECD, but have not reached a conclusion. The Cairns Group argues that agricultural export credits must be brought under effective international discipline with a view to ending government subsidization of such credits.

The extent of reductions in tariffs by the end of the 1990s will be even more modest than for export subsidies: the unweighted average bound tariff cut must be 36 percent (24 percent for developing countries), but it could be less than one-sixth as a weighted average, because each tariff item need be reduced by only 15 percent of the claimed 1986–88 tariff equivalents (10 percent for developing countries). Moreover, the claimed tariff equivalents for the base period 1986–88, and therefore the initial tariff bindings, are in many cases far higher than the actual tariff equivalents of the time. The European Union, for example, claimed tariff equivalents on average about 60 percent above the actual tariff equivalents of the Common Agricultural Policy in recent years, while the United States set theirs about 45 percent above recent applied rates—and developing countries are even more involved in the practice. Thus, for most farm products and countries, actual tariffs will provide no less protection after the turn of the century than did the nontariff import barriers of the late 1980s and early 1990s, according to Ingco (1996).

On market access barriers, the objective of the Cairns Group is to achieve deep cuts in all tariffs as well as the removal of tariff peaks and the redressing of tariff escalation. Again, the aim of the group is to place market access for agricultural commodities and value-added agricultural products on a similar footing as trade in other commercially traded products. The impact of tariff escalation is apparent, even at an aggregate level, when tariffs on processed food products are compared with agriculture and other products. For example, the OECD calculates that the production weighted average tariff rate in 1996 on the food, beverage, and tobacco sector in the European Union was 32.5 percent, compared with an average of 10.7 percent for the agriculture, forestry, and fisheries sector, and 7.7 percent across all products (OECD 1999). For the United States the figures were 15.9 percent for the food sector, 7.9 percent for agriculture, and 5.2 percent for all products (OECD 1999).

At least three options for reducing bound tariffs present themselves. One is a large across-the-board tariff cut. Even if as much as a 50 percent cut by, say, 2005 was accepted, however, that would still leave some very high tariffs. A second option is the "Swiss formula" used for manufactures in the Tokyo Round, whereby, the greater an item's tariff level, the greater the rate of reduction. This has the additional economic advantage of reducing the dispersion in rates that was introduced or exacerbated during the Uruguay Round. A third option is the one used successfully in the information technology negotiations, namely, the "zero-for-zero" approach whereby, for selected products, tariffs are eliminated altogether. In contrast to the second option, this third option would increase the dispersion of tariffs across products, increasing the risk that resources would be wastefully diverted from low-cost to higher cost activities. Although that might appeal as a way of allowing attention to then focus on the politically difficult items such as dairy and sugar, the manufacturing sector experience with long-delayed reductions in protection of textiles and cars makes it difficult to view this option optimistically as a quick solution. The continued existence of nontariff barriers for a number of products is also a target for the Cairns Group. The objective of the Group is to transform market-access barriers to tariffs and remove nontariff barriers to trade. In the interim, the Cairns Group supports substantial increases in trade volumes under tariff rate quotas (TRQs) and administration of TRQs in a manner that does not diminish the size and value of market access.

On the third fundamental set of restrictions, domestic supports, the Cairns Group aims to achieve the elimination of all trade-distorting domestic supports (including those in the so-called "blue box") or the

replacement of these with non-trade-distorting (decoupled) methods of assistance. Under the Uruguay Round, the aggregate measure of support (AMS) for industrial-country farmers is to be reduced to four-fifths of its 1986–88 level by the turn of the century. As with other measures, that too will require only modest reform in most industrial countries because much of the decline in the AMS had already occurred by the mid-1990s. That was possible because many forms of support need not be included in the calculation of the AMS, the most important being direct payments under production-limiting programs of the sort adopted by the United States and the European Union. However, as argued by Roberts, Podbury, Andrews, and Fisher (1999), if decoupled support is to be effective as a means of replacing market-distorting forms of support, it is important that these supports be implemented in a way that is minimally distorting and that they be applied consistently. For example, the direct-market support payments provided by the United States under the Federal Agricultural Improvement and Reform Act of 1996 have been made significantly more distortionary by the additional supplementary payments provided in 1998 and 1999 related to the low commodity prices that prevailed during that period. If farmers believe that future payment levels will be influenced by future prices, such payments will not be minimally distorting. Consequently, the objective of the Cairns Group is that income aids or other domestic support measures should be targeted, transparent, and fully decoupled so that they do not distort production and trade.

Biotechnology, Development, and Multifunctionality

The Cairns Group also has positions on three other nontraditional issues of significance for the forthcoming negotiations. First, the Vision Statement reaffirms the group's support for retaining the principle of special and differential treatment for developing countries, including least developed countries and small states, as an integral part of the next WTO agriculture negotiations. The Cairns Group ministers agreed that the framework for liberalization must continue to support the economic development needs, including technical assistance requirements, of these WTO members. As stated by the Cairns Group:

Major challenges facing many developing countries are the persistence of rural poverty and the linkages between such poverty and serious environmental problems. Consequently, more sustainable agricultural development remains a central policy issue in many developing countries. An improved international trading environment, that is more conducive to supporting agricultural develop-

ment, is needed as an essential ingredient in addressing these problems.

An improved international trading environment will not only improve the trading environment for agricultural exporting nations but will also have important implications for global food security. Food security will be enhanced through more diversified and reliable sources of supply, as more farmers, including poorer farmers in developing countries, are able to respond to market forces and new income generating opportunities, without the burden of competition from heavily subsidized products. To provide further assurance to net food importing countries, export restrictions must also not be allowed to disrupt the supply of food to world markets. U.S. moves toward reconsidering its use of unilateral trade sanctions on certain countries will be important in increasing the confidence of other countries to rely on the world market for achieving their food security objectives. However, while the prospect of imposing such sanctions still remains, the full confidence of net food importing countries will be difficult to attain. Similarly, the use of export taxes by the European Union in 1996 when grain prices were already at high levels undermined the confidence of net food importing countries for relying on the global trading system. A commitment to rescind that authority would also significantly improve the confidence of net food importing countries.

The second nontraditional issue on which the Cairns Group has a position is in its response to the United States and Canada regarding their desire for discussions or negotiations on trade in products of biotechnology in the forthcoming negotiations. The concerns on products of biotechnology relate mainly to the approval processes for these products and the extent to which they are already covered within existing WTO agreements. Although it could be argued that the products of biotechnology—principally agricultural products and pharmaceuticals—clearly come within the ambit of various agreements within the WTO, a key concern is the attempt by some countries to delay approval of these products or to restrict trade in these products for non-science-based reasons (Nielsen and Anderson 2000). Proposals being considered for including these products in the forthcoming negotiations range from a proposal by Canada to establish a working group to examine the applicability of existing agreements to these products to the proposed reopening of the Sanitary and Phytosanitary Agreement (or possibly attaching new understandings to the agreement). Although there is still considerable debate as to how this issue should be addressed, the Cairns Group notes that its members would

be prepared to consider how issues affecting trade in these products might be addressed by the WTO.

The third nontraditional issue on which the Cairns Group has a position relates to the concept of “multifunctional” objectives of agriculture, which has been pursued, in particular, by the European Union and Japan. The multifunctional objectives of agriculture go beyond the economic objectives of farm production to include such things as the rural amenity provided by farms, the social objectives of preserving regional populations, the advantages of agriculture in adding to biodiversity and the landscape (by preserving, for example, hedgerows in Europe), and for keeping farms in production for flood mitigation purposes (as argued by Japan). Although the Cairns Group does not disagree that farms can achieve such wider social and environmental objectives, it does not believe that this should be used as a reason for maintaining trade-distorting support arrangements. Rather, these objectives would be more efficiently and effectively met by simply making payments that are directly targeted at the objective—for example, by paying some landowners not to destroy their hedgerows (Anderson 1998). Moreover, trade-distorting support arrangements can actually have a negative impact on the achievement of some of these objectives. For example, in many cases agricultural subsidies and access restrictions have stimulated farm practices that are harmful to the environment. Reform of these policies can contribute to the development of environmentally sustainable agriculture (Anderson 1992).

Conclusion

There are many other issues beyond agriculture that will be important in the WTO negotiations. Although these issues extend to other sectors, such as industrials and services, they can have an important impact on agriculture: reducing input costs for agriculture (including farm material inputs, labor, and investment funds), improving the purchasing power of net food importing countries, and providing gains in other sectors that will make countries more willing to accommodate reform in the agricultural sector. With a new mandated round of WTO negotiations on agriculture and services, the challenge for reform-minded policymakers is to identify potential agreements that are most useful in mobilizing the required domestic political support for reforms to farm policies. On the one hand, it might be argued that farm policies would get more attention if the next round’s agenda were restricted to just agriculture and services. On the other hand, however, the probability of sizable agricultural protection cuts may

well be greater if negotiations include policies of other sectors. With the WTO's wider coverage than the General Agreement on Tariffs and Trade, multilateral trade negotiations now provide far greater scope for pursuing such linkage strategies.

On agriculture, traditional agricultural market-access liberalization should continue to be a key priority in the next WTO round. The gains from such reform have been demonstrated to be substantial. As discussed, the Cairns Group has reaffirmed its commitment to achieving a fair and market-oriented agricultural trading system as sought by the Agreement on Agriculture. Bringing agriculture more in line with trade in other goods will assist in removing the separate class structure of goods presently existing in the WTO, and so improve the efficiency of trade and resource allocation worldwide.

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LIBERALIZING TRADE IN SERVICES

J. Robert Vastine

The services sector—certainly compared with other sectors—is well informed and ready to take advantage of the next round of World Trade Organization (WTO) services negotiations set to begin later this year. The United States has a particularly big stake in these negotiations, a stake rising to the level of a national economic security imperative.

I believe these negotiations will further expand U.S. global markets, enabling our service sector to increase its 77 percent share of U.S. employment, its 79 percent share of gross domestic product, its trade surplus of about \$80 billion, and its 30 percent share of U.S. exports. Because foreigners have a great tendency to consume U.S. services, negotiations that reduce barriers across a wide range of highly protected foreign services markets could materially stimulate U.S. trade. The United States is very competitive in virtually every category of services trade (see appendix).

One recent suggestion has been that successful multilateral services negotiations could offset the structural goods deficit. Catherine Mann (1999: 9) wrote as follows:

As income in a foreign country grows, its imports of U.S. services tend to rise disproportionately. Successful broad-based negotiations on trade in services will likely increase U.S. exports of services even further, with a positive effect on the trade deficit. The long-term trajectory of the U.S. external balances could be altered significantly by the combination of successful service-sector negotiations and broad-based liberalization and deregulation at home and especially abroad. These together would unleash higher productivity and faster growth at home and abroad, which would narrow the U.S. current account deficit.

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Mann cites estimates by Gary Hufbauer and Tony Warren (1999) that comprehensive liberalization of services could raise global gross domestic product by 4 to 6 percentage points, and raise the long-run global growth rate from 3.2 to 5 percent.

My point is that the United States has a powerful national economic security interest in making the coming services negotiations a major success. But so does the rest of the world.

The Post-Seattle Agenda

Despite the setback in Seattle, WTO members can still make progress toward liberalizing trade in services. For the service sector a successful round of negotiations must

- Fulfill the mandate of the Uruguay Round's "built-in agenda" to start comprehensive services negotiations this year.
- Provide that negotiations be focused mainly on services, agriculture, and industrial products so that there is a real chance that negotiators can focus on services trade and complete an ambitious agenda of liberalization in areas where the likelihood of liberalization exists. This rules out, in my view, an effort to reach a multilateral agreement on investment.
- Recognize that electronic commerce is an important new technique for trading, not a new sector in and of itself; extend the existing moratorium on duties on electronic transmissions; call on countries to refrain from adopting measures that would unnecessarily restrict electronic commerce; and provide that electronic delivery of services falls within the scope of the General Agreement on Trade in Services, and that there be no discrimination among foreign and domestic providers in their access to electronic networks.
- Provide that the entire new "round" be completed by December 31, 2002, to force closure on the existing agenda, reap what gains can be garnered, and begin again with a fresh agenda that could include items like investment.

Ambitious U.S. Goals for Services 2000

The United States should enter new negotiations with a bold agenda, calling for sweeping commitments to liberalization across as many sectors as possible. New sectors requiring attention in a new round should include energy services, health services, air cargo services, legal services, as well as financial services, telecommunications, and others.

We would like our negotiators to propose broad commitments to liberalization in areas such as the right to establish a business presence

in foreign markets (commercial presence), the right to own all or a majority share of that business, and the right to be treated as a local business (national treatment).

If we are to succeed, our negotiating methods will need to be bold and innovative. We support the efforts of U.S. services negotiators, joined by their colleagues in the Quad (the United States, Canada, the European Union, and Japan), and a group of other countries with strong interests in services trade to find new approaches to services trade liberalization, approaches designed to supplement the usual “request-offer” approach, save time, and bring better results.

These new approaches could include commitments that apply “horizontally” across all service sectors, the negotiation of transparency and other pro-competitive regulatory commitments for service sectors under negotiation, then the negotiation of model schedules for each sector under negotiation. Countries would have the right, as they do now, to list exceptions to the model schedules and pro-competitive regulatory commitments. Once the models were adopted, countries could engage each other in negotiations to improve the scope and depth of other countries’ commitments.

One of the areas requiring fresh thinking here and abroad is the provisions used by countries, including the United States, for the temporary entry of foreign managerial and technical personnel. Increasingly, large, highly competitive U.S. companies such as consulting, accounting, legal, architectural, and engineering firms and information technology companies need to transfer personnel at short notice to service the needs of their clients throughout the world. In the parlance of the General Agreement on Trade in Services, delivering services via transfer of natural persons is known as “Mode 4” of supply. The WTO has been unable to make any progress on achieving liberalization of this form of supply of services. Because it is increasingly important to U.S. firms, and to some other countries, it should be a major element of the coming negotiations.

Foreign companies entering new markets often face formidable barriers in the form of arbitrary and nontransparent regulations and regulatory institutions. Such regulations too often deny foreign companies the opportunity to compete on an equal basis with domestic firms. They can effectively negate the benefits of trade liberalization commitments.

Pro-competitive regulatory reforms mean abandoning forms of regulation by which governments limit the introduction of new products, restrict use of market-based pricing, and in other ways constrain competition.

Transparency of regulatory processes is an important element of pro-competitive reform. It involves adopting many of the procedures embodied in our more open system of government, such as the publication of existing and proposed regulations, and the right to comment and to be heard in administrative proceedings. It also involves applying higher principles of how companies operate, such as ensuring solvency, promoting transparency in intracompany transactions and financial reporting, and improving the reliability of financial data to allow customers and investors to make better informed judgments.

Conclusion

Reducing barriers to trade in goods began many decades ago with the 1934 reciprocal trade agreements of the Roosevelt era. Reducing barriers to trade in services is in its infancy. The Uruguay Round wrote the “constitution” or legal framework for liberalization of trade in service: the General Agreement on Trade in Services. But countries’ actual commitments to liberalization were disappointing. The actual work of liberalization was advanced in the successful 1997 Basic Telecommunications and Financial Services negotiations. The next negotiation is the first real opportunity to bring to bear the lessons we have learned about the complex process of negotiating freer trade in services and to broaden binding commitments across all sectors and deepen commitments within product categories and subcategories.

The United States has a particularly big stake in a successful multilateral negotiation. We are already highly competitive in services. We can secure and enhance this comparative advantage by removing restrictions to our exports, and at the same time make a bigger and bigger dent in our structural trade deficit.

The Seattle ministerial was to be a preamble to the main event, the negotiation itself. But even more important is that the WTO members give a strong impetus to an ambitious, achievable negotiation in services. Such a result is essential to our national economic interest and to global prosperity.

Appendix

Following are examples illustrating the stake of U.S. service industries in expanded global markets:

Travel and tourism contributed over \$25 billion to the services trade surplus in 1997. That is the largest sectoral contribution to the overall services surplus. In addition, travel and tourism are estimated to support over 7 million direct jobs and generate roughly \$71 billion in tax revenues for federal, state, and local governments.

Business, professional, and technical services are a largely unrecognized powerhouse in American trade. In 1997, we exported more than \$21 billion in these services and we had a \$16 billion trade surplus. These data do not include the earnings from foreign investments and foreign affiliates, which are substantial. Trade in business, professional, and technical services—such as accounting, legal, engineering, architectural, and consulting services—is especially important because it frequently paves the way for trade and investment in other service and manufacturing sectors.

Telecommunications services are an integral component of operations of all businesses, and are essential in promoting domestic and global growth. Telecommunications services provide the necessary infrastructure for the development and continued expansion of the information society and electronic commerce. An estimated \$725 billion in revenue was generated in 1997, and projections for the next five years indicate that traded telecommunications services will increase at about 20 percent annually for outbound calls from the United States to foreign markets.

The information technology industry also depends on trade and trade expansion. The WTO estimates that over the next five years, sales over the Internet will double each year.

The U.S. asset management industry is the largest in the world. It is estimated that by 2002, 51 percent of total asset management revenue of \$160 billion will come from abroad, not the United States. Today, U.S.-domiciled investment managers control 14 percent of the total of non-U.S. retirement plan assets and 5 percent of non-U.S. mutual fund assets.

U.S. law firms, when billing foreign clients, produce services exports. Overall, U.S. legal services exports approach \$1 billion.

Foreign students coming to American schools, net after scholarship and local assistance, spent \$8.3 billion in the United States. That is a U.S. services export. We have a surplus in trade in education services of \$7 billion.

Although few doctors imagine themselves as U.S. exporters, medical services rendered in the United States to foreign citizens produced an export surplus of \$0.5 billion.

Air cargo transport accounts for well over a third of the value of the world trade in merchandise. However, restrictions on market access (including cabotage), ownership and control, the right of establishment, capacity, frequencies, intermodal operations in connection with air services, wet leasing, customs, ground handling, the environment, and local airport access times all limit the ability of cargo carriers to plan their operations purely on the basis of commercial

and operational considerations. A WTO framework could provide cargo carriers with clear rules addressing these problems and resulting in enhanced delivery options to the benefit of businesses, shippers, and consumers worldwide.

Energy services have received little attention in trade negotiations to date. But drastic changes in the international and domestic business climate for this industry—which in the United States accounts for 1.4 million jobs and about 7 percent of U.S. gross domestic product—have shown the need for global trading rules. Such rules can provide new, common understandings on key matters, for example, monopoly power, anti-competitive practices, and discrimination against new market entrants, including, of course, U.S. companies. Thus, the energy services industry looks to the coming round as a critically important opportunity to map out a blueprint for market access and free competition in energy service.

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DEVELOPING COUNTRY TRADE POLICY REFORM AND THE WTO

Razeen Sally

Less-than-rich countries now play an increasingly important role in international trade and investment. Since 1980, their share of world manufactured exports has doubled from 10 to 20 percent. Over a third of foreign direct investment (FDI) goes in their direction, up from 14 percent in the late 1980s. According to World Bank projections, their shares of world trade and output could roughly double to 50 percent and 30 percent, respectively, by 2020.

Correspondingly, developing countries and countries in transition play a weightier role in international trade policy. They account for over three-quarters of World Trade Organization (WTO) membership today—a share that is set to increase further as new countries gain accession (including Russia and China).

For much of the postwar period most developing countries, accounting for about half of the world's population, pursued interventionist and protectionist policies, and were marginal players in the General Agreement on Tariffs and Trade. In addition, a third of the world's population lived in centrally planned economies almost hermetically sealed from the world economy and not even members of the GATT.

In the last decade-and-a-half, though, a sea change in trade policies has taken place alongside policy reform in other areas. Thirty-three developing countries (almost half of all developing countries with protectionist policies) swung from relatively closed to relatively open trading regimes between 1985 and 1995. In roughly the same period, the number of them with liberal or mostly liberal regimes of cross-border capital movements swelled from 9 to 30. Since 1990, three-quarters of countries in transition have liberalized trade-and-payments

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regimes in the most dramatic episode of economic liberalization the world has ever seen.

These basic facts are symptomatic of something bigger and more profound. One of the hallmarks of policy reform in the 1980s and 1990s was the embrace of international economic integration (or globalization) by many poorer parts of the world. Although it is occurring somewhat gradually and patchily, there seems to be rising awareness and appreciation of globalization's advantages, allowing national economies to allocate resources more efficiently through specialization and exchange (in static terms), and (in dynamic terms) to reap productivity gains and higher growth through widening the geographic range of markets and increasing exposure to world-class competition and technology transfer, among other things. Recent comparative economic performance confirms these propositions. There is mounting evidence of the link between external openness and higher growth. On the trade front, for instance, the fastest growing developing and transition countries are clearly those with the highest degree of openness to imports and exports (Sachs and Warner 1995; Edwards 1998).

Nevertheless, this overhaul of trade policy, in a liberalizing direction, is very patchy and uneven. If anything, *divergence* of policy in the developing and transition world has increased since the 1970s and 1980s. A minority, mainly in East Asia, Latin America, and Eastern Europe, have liberalized trade and investment extensively (in tandem with macroeconomic stabilization, internal price liberalization, privatization, and institutional reform) and reaped the attendant benefits of higher growth. The vast majority, especially in Africa, the Middle East, South Asia, Southeastern Europe, and the ex-Soviet Union, have liberalized very partially and fitfully, and are on correspondingly lower or, in some cases, even negative growth paths.

This sets the scene for the fit between the WTO and national trade policy reform in the less developed world. Multilateral trade negotiations and agreements have formed part of national strategies of external liberalization, and a new round of WTO negotiations could well be a pillar of redoubled efforts in this direction. However, there are other important foundation stones and pillars supporting the edifice of outward-oriented trade policy. The next round should be seen within this scaffolding (if you will indulge my Schumpeterian taste for architectural metaphor). This takes us from the basement to the ground floor of the discussion.

The next section looks at the different national tracks of trade liberalization and tries to identify the complementarities and contradictions between the multilateral (WTO) track and other tracks. The following section then views WTO negotiations themselves through

the prism of multitrack national trade policy. What are developing and transition country interests, and what positions should these countries adopt, in multilateral trade negotiations? What is the state of their political and institutional capacity to set and achieve objectives, and what political strategies would be most appropriate? Not least, how would further WTO-track liberalization relate to unilateral and regional tracks of liberalization, with the objective of achieving closer national integration with the world economy?

Three Tracks of Trade Policy

In this section I view national trade policy as a multitrack endeavor. There are three primary tracks: unilateral, multilateral, and plurilateral. One or more are used at any one moment; the absolute and relative importance of each may vary over time. In the 1990s, developing and transition countries have proceeded along all three tracks simultaneously. It is therefore appropriate to pinpoint the advantages and disadvantages of each track, and the manner in which they interrelate.

The Unilateral Track: Liberalism from Below

It is often forgotten that the bulk of recent trade-and-investment liberalization in the developing and transition worlds has taken place unilaterally; that is, governments have liberalized quotas, tariffs, licensing arrangements, restrictions on FDI, and state trading monopolies independently and not as part of international agreements. Although many governments have reluctantly undertaken unilateral liberalization as part of International Monetary Fund and World Bank structural adjustment programs, the really strong and sustained liberalizers, such as Chile and Argentina in Latin America, Estonia and the Czech Republic in Eastern Europe, the East Asian newly industrialized economies and China, have gone ahead under their own steam, largely without the need for external pressure. Among the developed economies, only Australia and New Zealand have undertaken radical unilateral liberalization in recent decades.

The benchmark example of unilateral free trade was Britain, which comprehensively dismantled all protectionist barriers between 1842 and the late 1850s, and then sustained free trade through thick and thin until World War I. For most of the 20th century the unilateral track was hardly used—until East Asian, Latin American, and then East European countries traveled down this route. Indeed, they did so in greater numbers and at faster speeds from the mid-1980s. Since the launch of the Uruguay Round, more than 60 developing countries have unilaterally lowered barriers to imports.

Unilateral liberalization is what I call “liberalism from below,” precisely because governments can simply go ahead and “just do it”—the trade policy equivalent of the Nike strategy. Policymakers need not wait to conclude bilateral, regional, or multilateral agreements—“from above,” as it were—to liberalize trade and foreign direct investment.

In economic theory and in practice, unilateral liberalization makes eminent sense. Nearly all the classical economists from Adam Smith to Alfred Marshall, as well as the great British economic policy reformers of the 19th century, vigorously promoted unilateral free trade on theoretical and practical grounds. To begin with, national gains from trade result directly from *import liberalization*, which spurs more efficient resource allocation. One important effect of import liberalization is to channel resources into profitable export sectors, removing the bias against exports inherent in protectionist regimes. Seen in this light, there is every reason to go ahead on the fast track of unilateral liberalization without wasting time on the slow track of reciprocal negotiations.¹

The case for unilateralism or “liberalism from below” is reinforced by rather persuasive and enduring political economy arguments. The alternative policy of reciprocity (“liberalism from above”), that is, using intergovernmental negotiations to achieve trade liberalization, is a politicized, time-consuming, and cumbersome affair. It encourages trade negotiators to think in terms of power games rather than economic efficiency. Meanwhile, rent-seeking interest groups continue to exercise influence with governments. Lastly, the game of reciprocity inevitably involves the threat of retaliation if one party believes that other parties are engaging in “unfair trade,” or are simply not making enough concessions on market access. The grand virtue of unilateral liberalization is that taking the direct route to freer trade, rather than the roundabout route of reciprocity, avoids the prospect of government failure and retaliation. It quite simply short-circuits the arbitrary poli-

¹The terms of trade/optimum tariff argument complicates the case in favor of unilateral liberalization and provides theoretical support for the alternative policy of reciprocity. The argument here is that countries exercising long-run market power in international demand for certain goods should only lower tariffs if others reciprocate, to avoid worsening terms of trade. However, in reality very few countries (if any at all) have such market power under long-run conditions. Therefore, a beautiful idea on the Olympian heights of theory (not for the first time!) turns out to have little relevance in the valleys of real-world trade and practical policy. This returns policy, *as a practical proposition*, to a presumption in favor of unilateral free trade. On the terms of trade/reciprocity debate, see Robbins (1958: 182–231) and Irwin (1996: 106–15).

tics inherent in intergovernmental negotiations (Sally 1998: 54–56, 94–95, 168–70, 198–99).

The Multilateral Track: Liberalism from Above through the WTO

As alluded to earlier, reliance on reciprocity *at the expense of* unilateralism can be disadvantageous. Apart from anything else, the political economy rationale of reciprocal liberalization is basically mercantilist: governments bargain over access to each other's *export* markets, conveying the mistaken impression that exports are "good" and imports are "bad." This kind of thinking creates a political atmosphere in which trade negotiators aim to extract as many concessions from other governments as possible on access to their markets, while at the same time striving to give away as little as possible on access to one's own market.

Although these demerits of reciprocity apply to the GATT/WTO track of trade liberalization, the latter does have considerable, even overriding advantages, particularly for less developed countries. The initial point to make here is that, for most of the 20th century, rich and poor countries have not been able to use the unilateral track because of unfavorable domestic political conditions. The external prop of an international agreement, whereby many countries move ahead with external liberalization in concert, can be useful to overcome domestic opposition. Since the late 1940s, the multilateral rules of the GATT/WTO have provided such a framework for progressive trade liberalization, especially through the basic principles of nondiscrimination embodied in the most favored nation (MFN) and national treatment clauses.

For most of the GATT's existence, developing countries were largely exempt from its rules and obligations. Consequently, a small club of developed countries ran the show and did not take developing country interests seriously in GATT deliberations. The Uruguay Round was a turning point: for the first time some developing countries played an active part in many negotiating areas. This was particularly the case with East Asian countries that had already undertaken significant unilateral liberalization and saw further multilateral liberalization as a logical underpinning and extension of their reform processes. Many Latin American countries followed by becoming active proponents of multilateral liberalization on the back of their unilateral reforms from the mid-1980s (in Chile's case, from the mid-1970s). The same thing occurred with Australia and New Zealand in the Organization for Economic Cooperation and Development. Previously, they had stood aside from GATT liberalization measures; after initiating their own

unilateral trade reforms, they began to push for multilateral liberalization, particularly in agriculture.

Therefore, on the basis of their own unilateral reforms and Uruguay Round experience, a significant block of developing countries is now in a far better position to appreciate the advantage of multilateral rules, and to play a more proactive role in shaping their future course. This applies equally to the ex-command economies that have joined the GATT/WTO since the early 1990s.

Multilateral rules provide the following advantages for developing and transition countries:

- Less developed countries are mostly small compared with the large trading nations of the developed world. They are highly dependent on trade and consequently have a large stake in the healthy growth of the international economy. As such, the protection of a well-functioning system of international trading rules is especially important to them.
- WTO rules, in return for certain obligations, provide less developed countries with *rights*: rights to market access to exports, and rights against the arbitrary and selective protection and predation of more powerful players in the developed world. Since the conclusion of the Uruguay Round, these rights have been enforceable through a strong, legally binding dispute settlement mechanism.
- Multilateral rules serve an important domestic political and economic function. Binding reciprocal commitments lock in previously undertaken measures of liberalization and help prevent a retreat into protectionism, especially in conditions of low growth or recession when domestic pressures for protection increase. Thus, the WTO mechanism *reinforces the credibility* of domestic policy reform in the eyes of exporters, importers, and local and foreign investors.
- International treaties strengthen the hand of governments and shift the balance of interest group politics within the domestic sphere. Binding international obligations protect governments against politically influential domestic producer groups clamoring for protection against imports. At the same time, intergovernmental negotiations mobilize the support of domestic exporters, who have a stake in lobbying their governments to “concede” market access at home in return for improved market access for their products abroad.

The Plurilateral Track: Liberalism in Between

In between the two aforementioned tracks is the plurilateral route, on which two or more countries come together to regulate trade.

Advocates argue that groups of like-minded countries can club together to take trade and investment liberalization deeper, wider, and faster than would be possible in the much larger and more diverse WTO. Indeed, the plurilateral track could be used to accelerate progress along the multilateral track. On the other hand, detractors argue that bilateral or regional trade agreements are a stumbling block in the multilateral trade order. The initial objection is that they can lead to international resource misallocation through trade diversion. More fundamentally, they are usually discriminatory, favoring members of the club at the expense of third parties, thereby violating the GATT's MFN principle. The danger is that regional trade agreements (RTAs) in particular can lead to a patchwork of opaque, overlapping, and discriminatory procedures, especially in the form of nontariff barriers such as rules of origin and domestic content requirements. This might easily divert time and resources from, and weaken the nondiscriminatory nature of, both multilateral and unilateral liberalization.

Most developing and transition countries have been part of the proliferation of RTAs since the early 1980s. To date, there has been no hard evidence that RTAs have impeded the growth of world trade and investment. Indeed, many would hold that regional initiatives, such as the European Community's Single Market program, NAFTA, MERCOSUR, and APEC, have had a net liberalizing effect and created additional trade and investment flows (WTO 1995). One should also mention the explosion of bilateral investment treaties: there are more than 1,600, three-quarters of which have been concluded since 1990. A growing number and proportion of these involve countries outside the Organization for Economic Cooperation and Development.

However, the very fact that *discriminatory* regional trade liberalization is ascendant poses serious questions for the rule-integrity of the WTO and the continued viability of unilateral liberalization.

Multitrack Liberalization: Complementarities and Contradictions

At this stage, let me try to pull together the elements of the preceding discussion and give an idea of where I think national trade policy should be heading and how it could proceed en route. To those who believe in free trade (broadly defined) as a means of enlarging the freedom to choose—for its own sake and as a handmaiden of greater prosperity—the end objective must be complete or near-complete integration with the world economy. Basically, this translates into the freedom of cross-border movement in goods, services, and capital, to the extent that residents in different countries should be as free to

transact business with each other as are residents of the same country.² Nondiscrimination between one's own citizens and foreigners, therefore, is the litmus test of free trade in practice (Henderson 1992: 635). Trade and investment liberalization along at least two, and possibly all three, tracks identified would be useful in working toward this goal. That said, it is very important to recognize how these tracks might complement and mutually reinforce each other, on the one hand, and how they might clash, on the other. Above all, indiscriminate and unreflective use of all three tracks might hinder rather than promote the cause of progressive external liberalization.

First, unilateral liberalization should be advocated much more powerfully and prominently; indeed, it should be the primary track, and first-order priority, for trade policy.³

Second, unilateralism on its own is often insufficient as a political strategy. Most developed, developing, and transition countries lack the domestic political requisites to undertake and sustain unilateral trade reforms. Even the benchmark examples of unilateral liberalization face domestic political pressures to reverse course when economic conditions take a turn for the worse. Crucially, the United States and the European Union (EU), the two major influences on the international trade policy game, remain wedded to reciprocity as the chief instrument to open markets worldwide.

Given these factors, the multilateral track of reciprocity can serve as a helpful auxiliary to unilateral liberalization. There is complementarity between the two tracks: unilateral liberalizers can lock in their reforms through binding WTO agreements; in turn, the latter can provide the springboard for further and deeper unilateral reforms.

This virtuous circle is already apparent in the expanding field of tradable services. Unilateral domestic deregulation and privatization, first in the United States and the United Kingdom, paved the way for GATT negotiations on trade-related services during the Uruguay Round. Also illustrative are the recent General Agreement on Trade in Services (GATS) agreements on financial services and basic telecommunications services. Developing country signatories view these multilateral agreements as crucial instruments to improve their service infrastructures, particularly by attracting FDI; some have since pro-

²Economic liberals would also advocate the freedom of people to migrate across borders, much along 19th century lines. Given present-day policies, however, this must remain a very long-term objective.

³This can be done without excessive, or even any, reliance on conditional aid, including aid from the International Monetary Fund and the World Bank. As the experience of strong reformers in the developing and transition worlds shows, domestic political economy factors, not aid, ultimately determine the long-run success or failure of trade policy reform.

ceeded beyond WTO commitments with further unilateral liberalization.

One important qualification: unilateral and multilateral liberalization can only be complementary if both are pursued on a *nondiscriminatory* basis consonant with MFN and National Treatment. If the end objective is full integration with the world economy through nondiscrimination as between own citizens and foreigners, WTO member-states should, first, undertake nondiscriminatory unilateral liberalization, and, second, pursue multilateral liberalization on an equally nondiscriminatory basis, with progressively fewer loopholes and get-out clauses in WTO agreements. Under such conditions, unilateralism and multilateralism would form a coherent whole in underpinning simple, transparent national trade policy regimes.

Third, the in-between track of plurilateral liberalization is more problematic. When it discriminates against third parties it adds to the opacity and political arbitrariness of trade policy regimes, and thereby undermines (nondiscriminatory) unilateral and multilateral liberalization. There is some evidence of this in Latin America and East Europe, where strong, nondiscriminatory unilateral liberalization has been arrested, at least in part because of the prioritization of regional trade agreements (in Latin America) and EU accession (in East Europe). Although discriminatory regional liberalization cannot be wished away, there are ways and means of making it less incompatible with unilateral and multilateral tracks. This should be one issue for the new round.

On the other hand, when the plurilateral track is used in a nondiscriminatory manner, there is a good fit between it and the other tracks. The best example of this is the loose form of "open regionalism" in the Asian Pacific Economic Cooperation forum, in which joint measures of liberalization are automatically extended to third parties in conformity with unconditional MFN.

WTO Negotiations and the Less Developed World

Developing and transition countries can improve their growth prospects by playing a more active role in the WTO and taking better advantage of its multilateral rule base. In particular, WTO negotiations present them with a golden opportunity to deepen their integration into the world trading system.

An Australian study, for example, estimates that halving global protection for agriculture, manufacturing, and services would boost the world economy by more than \$400 billion annually, double the welfare gains from the Uruguay Round. All countries stand to gain: developed countries would gain more in absolute terms, but less

developed countries would benefit more if gains were expressed as a proportion of gross domestic product. If anything, these are conservative estimates: they do not take account of the longer-run dynamic effects of trade liberalization (Ministry of Foreign Affairs, Australia 1999).

Thus, developing and transition countries should focus more on the multilateral track of trade and investment liberalization. However, this does not mean that they should veer away from other tracks, particularly unilateral liberalization. On the contrary, they should accelerate progress along unilateral and multilateral tracks concurrently, while seeking to avoid some of the pitfalls of the plurilateral track.

Further Unilateral Liberalization

Nearly all less developed countries still have wide scope to undertake further unilateral liberalization of tariffs, nontariff trade barriers, and inward investment. In agriculture, many countries retain an anti-export bias due to government-induced distortions that favor inefficient but politically well-connected urban manufacturers. In manufacturing, trade-weighted MFN applied tariffs are still high in South Asia and North Africa (just under 30 percent), although they have come down to fairly low levels (just above 10 percent) in East Asia and Latin America, and even lower levels in Eastern Europe (about 6 percent). Developing country exports continue to be hindered by tariff peaks (on sensitive goods) and tariff escalation (on processed, higher value goods) in other developing countries.

Further liberalization in both agriculture and manufacturing, for example, by lowering tariff peaks (to 5–15 percent) and setting a low uniform tariff, would reduce or remove the bias against tradable goods and shift productive resources into export sectors. Liberalization of own services markets, critical to improving domestic infrastructure, would feed through into greater efficiency in agriculture and manufacturing. Farmers and manufacturers are now handicapped by severe supply bottlenecks, especially backward transport and communication infrastructures. Lastly, abolishing discriminatory restrictions on foreign-owned firms and according them National Treatment, and launching further privatization measures, would send the right signals to attract more FDI.

The strong and sustained trade policy reformers in Latin America, East Asia, and Eastern Europe have also been the most prominent unilateral liberalizers. Their task is to combine more liberalization with domestic institution-building measures to entrench and deepen the reform process. The vast majority of less developed countries, in

contrast, have been reluctant unilateral liberalizers and are well behind the first division in terms of overall liberalization. Their task is to proceed with the basic steps of external liberalization, for example, abolishing quotas and licensing restrictions, lowering tariffs and tariff dispersion, and taking away remaining restrictions on FDI.

Thus, less developed countries still have a large trade and investment liberalization agenda ahead of them, much of which can be achieved unilaterally, without waiting for the negotiation and conclusion of international agreements. *Wherever and whenever politically feasible, unilateral liberalization should be pursued on its own merits and not held back as a bargaining chip in multilateral or regional negotiations.* To repeat an earlier point, *unilateralism should be the primary track and first-order priority of trade policy.* This is one important maxim developing and transition countries should take to heart as they enter important WTO negotiations in 2000. They would be making a grave mistake and harming their self-interests if they were to slow down on the unilateral track in the belief that further liberalization should only be “conceded” in WTO negotiations in return for export market access. That would be the fast track to denying themselves the benefits of speedy and substantial import and inward investment liberalization.

Contrary to received wisdom among politicians, trade negotiators, and assorted experts, continuing and accelerated unilateral liberalization would be perfectly compatible with the vigorous pursuit of own interests on the multilateral track. Above all, the latter should be regarded as a lock-in mechanism for ongoing national reforms by binding previously undertaken measures of unilateral liberalization, increasing the costs of reform reversal, and providing extra sustenance to domestic interests favoring open markets. The effective combination of the two tracks would best reinforce the credibility of national trade policy regimes in the eyes of domestic and foreign investors. Seen in a “classical-liberal” or “constitutional” light—“from below” in terms of the quality and consistency of the national policy framework—the emphasis should be to use a combination of unilateralism and multilateralism to strengthen private property rights in international transactions. That, after all, is part and parcel of Adam Smith’s “natural liberty, upon the liberal plan of freedom, equality, and justice.”

Regional Trade Agreements

There is no harm in using the plurilateral track to advance trade and investment liberalization providing there is no discrimination against third parties. This is why APEC should be regarded as a helpful auxiliary to both unilateral and multilateral liberalization. Dis-

criminary RTAs, however, are another matter. At present, Article XXIV of the GATT and Article V of the GATS, both loosely worded and effectively unpoliceable, seem to provide a floor rather than a ceiling for the proliferation of *preferential* trading arrangements, thereby undermining the nondiscriminatory basis of the WTO. As part of the Millennium Round, all member-states should enter negotiations with a view to strengthening the surveillance of RTAs, and to tightening the WTO rule base, particularly concerning the use of rules-of-origin requirements.

WTO Negotiations

With a greater share of international trade and FDI, and a louder voice in the WTO, developing and transition countries have a window of opportunity to actively shape the next round of negotiations and help see it through to a successful conclusion. They should clearly and precisely identify a shopping list of positions consonant with their national interests, and then act as forceful *demandeurs* in forthcoming WTO deliberations.

However, many developing countries, led by Egypt, India, and Pakistan, would prefer multilateral negotiations to stick to the WTO's "built-in" agenda: implementing the Uruguay Round agreements and further negotiations on agriculture and services. This strategy is unwise. Instead, less developed countries should support a broad agenda with pansectoral coverage. A limited agenda would likely deliver liberalization only or mainly in areas of interest to developed countries. A broader agenda, on the other hand, would offer something to all participants and allow for trade-offs between negotiating areas. This is the best hope for liberalization in the interests of less developed countries. By "conceding" market access in services, binding tariffs at low rates, and restricting the use of special and differential treatment—all in any case in their self-interests—less developed countries would have a better chance of extracting developed country concessions on textiles and clothing, agriculture, industrial tariffs, and so forth. Moreover, interest groups are more likely to mobilize in support of trade liberalization if the next round covers a wide range of sectors.

If most less developed countries go to WTO negotiations with a negative and reactive mindset, they would form an unwitting coalition with anti-globalization nongovernmental organizations to block the launch of a new round. This would probably undermine the WTO's credibility and increase protectionist pressures. A proactive mind set on the part of less developed countries, on the other hand, would be crucial in launching a broad and ambitious negotiating agenda. This would prevent backsliding into protectionism, enhance the credibility

of the WTO, and set the ball rolling in the direction of significant welfare gains from further trade liberalization. *Developing and transition countries now have the double-edged power to block progress in the international trading system, or to push it onto a faster track.*

Developing and transition countries should consider staking out and pushing the following positions for a new round:

A Single Undertaking. A “single undertaking” approach should be followed, that is, the results of the round should be adopted in their entirety and applied to all WTO members. Less developed countries should agree to restricting Special and Differential Treatment to technical assistance and, as a last resort, longer implementation periods for WTO agreements, while otherwise accepting nondiscriminatory rules-based obligations (particularly MFN). A focus on across-the-board lowering of trade barriers, underpinned by rules applying equally to all members of the club, would be of much greater benefit to less developed countries than a continued fixation with, for example, the Generalized System of Preferences. The latter has delivered scant gains to poor countries and been a costly diversion of their political and administrative resources.

Less developed countries should also agree to

- Make less use of Article XVIII of the GATT, which sanctions exchange controls and quotas on balance of payments and infant industry grounds.
- Bind their WTO MFN tariff ceilings at or close to applied rates. At present, only 59 percent of developing country tariffs are bound (compared with almost 100 percent for both developed and transition countries), and there are large gaps between applied and bound rates. Although average applied tariffs in developing countries post–Uruguay Round are 13 percent, bound tariffs hover around 20 percent. In Latin America, for instance, applied rates are relatively low as a result of unilateral liberalization, but their WTO bound rates are thrice as high (30 percent). In East Asia and Eastern Europe they are twice as high (20 percent and 13 percent, respectively). In South Asia and North Africa, bound tariffs are close to 50 percent.
- Make substantially more bound commitments in the GATS. Most unilateral reforms in developing country service sectors remain unbound; in fact, less than 20 percent of maximum possible commitments have been bound in the GATS.
- Desist from increasing anti-dumping actions.

All of the preceding measures would serve two purposes: strengthen the credibility of national trade policy regimes and improve the chances of major developed country concessions in other areas.

The Multifiber Arrangement. Less developed countries should insist, *as an absolute precondition*, that developed country undertakings made in the Uruguay Round, especially on the phaseout of the Multifiber Arrangement, be carried out in full. This should be followed by significant tariff reductions in textiles and clothing.

Agriculture. Developing country exports are hindered by high tariff and nontariff developed country protection in the agriculture, fisheries, and food industry sectors. Agricultural liberalization should be accelerated by reducing peak tariffs, tariff escalation, and domestic support as well as eliminating export subsidies. In addition, less developed countries have a big stake in ensuring that WTO sanitary and phytosanitary (SPS) regulations are based on scientific evidence rather than being used as a backdoor for protection. SPS measures introduced by developed countries are a growing barrier to market access for developing country exports. Less developed countries must participate more actively in WTO deliberations on SPS.

Industrial Tariffs. High tariffs and tariff escalation on processed goods continue to distort resource allocation and cramp trade in politically sensitive sectors such as textiles and clothing, steel, footwear, travel goods, transport equipment, automobiles, and energy products. Many of these sectors are of great export interest to less developed countries. Tariff peaks and tariff escalation should be substantially reduced, *particularly in the textiles and clothing sectors*. Last, a deadline should be set for duty-free access to all goods exported by least developed countries.

Antidumping. Rather arbitrary antidumping (AD) actions hit small firms and new entrants from less developed countries particularly hard. They are less able than firms from developed countries to fight AD actions in political and bureaucratic arenas, and to comply with the often prohibitively high costs of implementing relevant administrative procedures. During the 1990s, developing countries increasingly resorted to their own AD actions, especially against other developing countries. Noticeably, Latin American countries, under pressure from domestic lobbies, have increased AD actions while abolishing quotas and steeply reducing tariffs (a similar trend has occurred in Australia and New Zealand).

Less developed countries should push hard to tighten AD procedures in Article VI of the GATT to reduce arbitrary and selective protection. However, it is unlikely that the EU and the United States will agree to radical multilateral restrictions on their AD regimes. Nevertheless, the issue should be raised. There is a long-odds chance that the United States and the EU will relent on antidumping if offered significantly greater access to developing country markets,

especially in services. Not least, less developed countries should take the long view by raising the issue now, which would improve the prospects of eventually beefing up Article VI.

Trade, Environmental, and Labor Standards. Less developed countries should firmly reject developed country demands for trade sanctions to enforce environmental and labor standards extraterritorially, which would introduce “green” and “brown” protectionism into the WTO. Higher environmental and labor standards are largely a reflection of more advanced economic conditions and more demanding consumer preferences in developed countries; they are inappropriate for poorer countries. The costly imposition of such standards on them would not be in line with their comparative advantages and would hinder exports.

At the same time, less developed countries should resist attempts by developed countries to use previous rulings by WTO panels or the Appellate Body to apply national or regional environmental regulations extraterritorially. This applies in particular to the Appellate Body ruling on the shrimp-turtle issue, which, while finding against the United States in the specific case, suggested that there might be grounds for extraterritorial application of national regulations providing there is adequate consultation. Arguably, this interpretation contravenes the provisions of Article XX of the GATT forbidding discrimination of imported goods by governments on the basis of how they are produced.

The environmental standards issue in particular is politically highly charged and potentially explosive. Well-funded and highly mobilized environmental nongovernmental organizations from developed countries are putting concerted and very public pressure on the EU and the United States to push the issue in the WTO. On the other hand, developing countries are adamant that they will not compromise on WTO trade sanctions to enforce environmental standards. The nightmare scenario that this will lead to deadlock and abort the Millennium Round project was realized in Seattle.

With this in mind, less developed countries must do their utmost to avoid a “nuclear” confrontation at the WTO, without compromising their baseline position and the integrity of WTO rules. They should consider adopting the following strategies:

- Advocate “win-win” solutions to reduce agricultural and fishing subsidies with environmentally beneficial effects.
- Agree to consider global environmental (and labor) problems more actively in non-WTO fora, for example, in the context of other international organizations.

- Agree to measures to improve WTO information disclosure, and to upgrade dialogue between the WTO and civil society constituencies. However, less developed countries should make it very clear that direct access to and participation in WTO deliberations are the exclusive preserve of member governments, not private parties. *The WTO is and should remain a strictly intergovernmental mechanism to negotiate trade liberalization according to multilateral rules.* Direct interest group participation, whether by nongovernmental organizations or business constituencies, would fatally undermine the WTO. This is a constitutional point of the utmost importance that should not be sacrificed on the altar of political correctness with respect to nongovernmental organizations. Ultimately, the WTO should be regarded as a bulwark of nondiscriminatory rules supporting private property rights in international transactions; it must not fall victim to nebulous and arbitrary concepts of “democracy” bandied about in the current cacophony on globalization.

Technical Assistance and Capacity Building. Most developing countries, especially the least developed (LDCs) among them, take little advantage of multilateral rules. Their main obstacle is weak or very weak institutional capacity. The WTO’s ongoing work and expanding coverage, particularly in the wake of the Uruguay Round agreements, require additional capacity from member governments. This is simply beyond the reach of LDCs with weak and corrupt governments, deficient civil services, and poor communications.

Perhaps most glaringly, poorer countries, and LDCs in particular, suffer from deficient legal resources for, and political/administrative monitoring of, WTO dispute settlement. All less developed countries should insist on the establishment of an independent advisory center on WTO law to assist LDCs and other less developed members in bringing and defending cases in the dispute settlement mechanism. This is all the more important because of the creeping legalization of the WTO. There is the danger that, given the “constructive ambiguity” of GATT and GATS texts, and following the shrimp-turtle ruling, policy decisions may be driven by WTO members able and willing to commit significant legal resources to dispute settlement cases. Less developed and smaller countries need to become more involved in dispute settlement to prevent this from happening, and to make sure that panel and Appellate Body rulings stick to the letter and spirit of WTO rules.

LDCs also require substantially increased financial and technical assistance to comply with intellectual property rights obligations, cus-

toms procedures, and SPS and technical standards imposed by developed countries.

Services. Less developed countries have a strong interest in further liberalization across-the-board in trade-related services. As mentioned earlier, liberalization of own markets, achieved unilaterally, plurilaterally, and multilaterally, will be critical to upgrading domestic transport and communications infrastructures. Air and maritime transport are two previously excluded sectors that need to be brought into GATS negotiations. In addition, less developed countries should campaign forcefully for export market access in service sectors in which they enjoy comparative advantage, especially in the cross-border movement of temporary labor (under Mode 4 of the GATS).

Other Issues. Less developed countries might consider supporting issues of lower but possibly worthwhile priority in return for developed country concessions in other areas. A WTO agreement on foreign direct investment would be at the head of this list.

Political Strategies for the Multilateral Trade Negotiations

Developing and transition countries face big obstacles in advancing many of the positions advocated here. To begin with, less developed countries have increasingly differentiated interests. Korea, Singapore, and Hong Kong have achieved high per capita income levels on the back of exporting a diversified set of sophisticated manufactures; other East Asian, Latin American, and East European countries are in the middle-income bracket and are also reliant on export-led growth; some developing countries are net exporters of unskilled labor-intensive manufactures; and at the extreme, there are LDCs who are net food importers reliant on external aid.

Differentiation of interests is matched by differentiation of capacity: Although most developing countries and the more backward transition countries are underactive or hardly active at all in the WTO, about 30 to 35 developing and transition countries are active or very active, with well-staffed WTO missions and strong representation in the formal and informal consultations that take place in the WTO. This group includes Chile, Mexico, Argentina, Brazil, the Association of Southeast Asian Nations countries, Korea, Hong Kong, the Czech Republic, Hungary, and Poland.

Given this diversity in the developing and transition world, it will be politically more effective for some less developed countries to join forces with some developed countries with whom there is common interest, both at a general, pansectoral level and at a more sector-

specific level. The paradigm is the Cairns Group, uniting agricultural exporters from developed countries with developing countries from Association of Southeast Asian Nations and Latin America. Also worthy of mention is the Chilean approach ahead of the Millennium Round, forging alliances with Australia and New Zealand on services liberalization, working through the Cairns Group on agricultural liberalization, and finding common cause with the EU on foreign direct investment.

Nevertheless, there are issues on which all developing and transition countries have common interests, such as resistance to trade sanctions to enforce labor and environmental standards, credit for unilateral liberalization, and technical support for dispute settlement. Here a united front would enhance bargaining power.

Ultimately, middle-income countries in East Asia and Latin America that have already undertaken extensive unilateral liberalization and participate actively in the WTO must take the lead. They should expect support from Eastern European countries in the vanguard of transition, although the latter can be expected to align their positions with the EU in preparation for EU accession. It is up to these advanced developing and transition countries to build alliances on separate issues with like-minded developed countries, as well as to make a concerted effort to persuade other developing and transition countries to jump on board a pro-liberalization agenda.

Other Issues

The message I have tried to relay in this article is that less developed countries should make maximum use of unilateral and multilateral tracks of trade and investment liberalization. These are complementary, not mutually exclusive routes to closer national integration with the world economy, provided that nondiscrimination is the lodestar of policy. Any new WTO negotiations should be seen in this context.

There are a couple of other issues I should like to mention. These are relevant, although indirectly, to the next round, and are of great moment to trade policy and trade policymaking in the less developed world.

The first issue concerns accession of new countries to the WTO. More than 30 countries are in the queue. The prospective accession of Russia and China in particular is bound to have a major impact on the future of the WTO. On balance, accession is good news, although it will put further strain on an already creaking WTO machinery that operates by consensus. Taiwan is the most promising accession candidate: WTO membership should spur further domestic reforms; and one would hope that this major trading nation will soon be in

the vanguard of East Asian and Latin American members of the WTO vigorously pursuing a pro-liberalization agenda. Regarding Russia and China, there is considerable political pressure from the United States and the EU to bring them inside the WTO tent as quickly as possible. However, other WTO members should take great care to ensure that accession takes place on the right terms, even if that takes time. It would damage the rule integrity of the WTO to have easy and hasty entry for a handful of (politically powerful) countries while the bar of accession seems to be getting higher and higher for other accession candidates.

The last issue I wish to flag concerns the management of trade policy *within* less developed countries with inevitably larger institutional deficits compared with developed countries. I have already highlighted the underrepresentation and inactivity of a majority of less developed members in the WTO. This is but a reflection of deep-seated and often seemingly intractable deficiencies in the trade policy process within the domestic sphere. Mention should be made of some of the more glaring problems: lack of clear political direction; overlapping competencies and turf fights between ministries; corruption and lack of professional expertise and competence in the civil service; lack of information on relevant trade policy issues; inadequate or nonexistent channels of communication with business constituencies with a stake in open markets (exporters, multinational enterprises, users of imported inputs); bad or non-existent coordination between WTO missions and national capitals; interest group capture of relevant ministries; inadequate appreciation and enforcement of property rights and contracts, including those pertaining to international transactions. Usually, these defects translate into a passive, muddling-through stance on the international trade policy scene. The heart of the problem is that politicians, bureaucrats, and even frontline trade negotiators do not have a clear conception of what national trade policy interests are, let alone how they can be achieved.

On the bright side, however, the first-division reformers in the less developed world (in Latin America, East Asia, and Eastern Europe) have made great strides in improving the quality of trade policy decisionmaking, largely on the back of unilateral reforms. Many now have a clearer appreciation of own interests, which translates into a more constructive, proactive role in the WTO.

Conclusion

Much solid research has been done on the applied economics and macropolitical economy of trade policies in less developed countries,

but very little has materialized on the micropolitical economy of the trade policy *process* in these countries. This should be addressed urgently so that we can understand better why governments do not make better use of different tracks of trade policy. This would be the first step to offering advice on how the decisionmaking process can be improved, hopefully going beyond not very insightful World Bank stylized facts.

The vast potential for improving trade policy decisionmaking and taking better advantage of unilateral and multilateral tracks of trade policy should not obscure a very important, indeed historic, trend. In recent decades, the West has been quite timid about further external liberalization; radical opening has occurred where, even a decade and a half ago, one expected it least—in developing countries, and more recently in countries in transition outside the traditional boundaries of the West. Hence, the paradox of modern trade policy: the free trade ambition, a Western idea and long a preserve of Western practice, has taken hold in parts of the South and East whereas it has retreated in parts of the West itself.

This trend, it should be added, is not impelled by the impersonal and inexorable external forces of globalization. There is nothing technically preprogrammed about external liberalization in today's world economy. Just as in the 19th century when the world was seemingly on course for ever closer economic integration, sovereign governments today remain largely free to choose—to make a variety of policy choices on whether and how they should integrate their economies with the world economy. This they do in reaction to (often unanticipated) events and crises, to interest group pressure, and to the changing climate of ideas and attitudes. All this plays out differently in different national contexts and in different circumstances, which accounts for the very real differences between national foreign economic policies (and consequently in comparative economic performance). How else is one to explain the divergence of policy and performance in the developing and transition worlds in our time? At the risk of sounding axiomatic, trade policy, like globalization itself, depends critically on political choice at the national level.⁴

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⁴My views on globalization and policy reform echo those of David Henderson in what must be the best, most savvy overview and interpretation of modern policy reform. See Henderson (1999).

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THE WTO'S SPECIAL BURDEN ON LESS DEVELOPED COUNTRIES

J. Michael Finger

The General Agreement on Tariffs and Trade was a card of professional wrestling, put on for a good cause. The political groans and grimaces that kept the true believers at the edges of their seats, an economist knew, were fake. In the GATT, the pains that participants complained about were mere politics. A government might protest having to cut its own tariffs, but an economist knew that those cuts would make the economy *more* productive, not less. The political discomforts were growing pains perhaps, surely not warning signs of injury.

Although the GATT was a game that an economist could enthusiastically cheer, the World Trade Organization is something else. Some of the concessions the WTO asks for (or assigns) are indeed economic costs, not mere mercantilist misperceptions. Although it did not make sense for an economist to ask about the GATT, "Is it worth it?" it does make sense to ask that question about the WTO.

The distinction I allude to between the WTO and the GATT is more precisely between liberalization of border measures such as tariffs and quantitative restrictions—the business on which the GATT was built—and the creation of rules on nonborder measures that affect trade. The latter is a considerable part of the WTO. At the Uruguay Round, countries took on major commitments to modernize regulations and institutions of trade administration—for example, customs valuation. Countries also took on obligations in areas usually thought of as domestic regulation—for example, intellectual property rights, industrial standards, and sanitary and phytosanitary (SPS) standards.

These matters, I suggest, differ in two ways from reducing trade restrictions: (1) implementation costs money and, therefore, (2) alter-

native uses are relevant—the money might be better spent elsewhere. Put another way, GATT-mandated reforms were a gift horse, and no economist would look a gift horse in the mouth. For what the WTO offers, one has to pay, so it makes sense to ask not only if this is the best horse for the money, but also if buying a horse is really the best use of the money.

None of the problems I take up here involve developing countries' commitments on trade liberalization. Indeed, on trade liberalization the developing countries' commitment—tariff reductions and elimination of quantitative restrictions—is now in place (January 1, 2000, deadline) and in scope as large as the industrial countries' commitment. The major market-access concession received by the developing countries is still to be implemented: the deadline for eliminating the Multifiber Arrangement is 2005. Liberalization of agriculture is yet to be negotiated. Trade liberalization by developing countries is a good thing and is proceeding apace of obligations (Finger and Schuknecht 1999).

Lessons from the World Bank Experience

As noted, WTO member countries at the Uruguay Round took on obligations in several areas of “domestic” regulation or trade process. For many of the less advanced members, meeting these obligations requires changes, installation of systems and of enforcement processes not now in place. To learn something about what is involved in this implementation, a colleague, Philip Schuler, and I reviewed the World Bank project experience in customs reform, intellectual property regulation, and sanitary and phytosanitary measures. In each of these areas we went through our review with four questions in mind:

1. How much does the implementation cost?
2. What are the problems developing countries face in these areas?
3. Does the WTO agreement correctly diagnose the problems?
4. Does the WTO agreement prescribe appropriate remedies?

“Appropriate” in the fourth question refers both to correctly identifying the problems and to recognizing the capacities (resource constraints) of the least developed countries.

The major lesson we drew from our review is that implementation will cost money and, thus, it is relevant to ask what return the investment will provide. In large measure, implementation involves spending from the development budget, and that task draws on the World Bank's expertise.

The project costs we identified provide a first approximation of the investments needed to implement WTO obligations on customs

reform, intellectual property rights, and SPS. Hungary spent more than \$40 million to upgrade the level of sanitation of its slaughterhouses alone. Mexico spent more than \$30 million to upgrade intellectual property laws and enforcement that began at a higher level than those in place in most least developed countries. We identified some 16 elements in customs reform, each of which can cost more than \$2.5 million to implement. The figures, for just three of the six Uruguay Round agreements that involve restructuring of domestic regulations, total \$150 million.¹ This sum is more than the annual development budget for 8 of the 12 least developed countries for which we could find a figure for that part of the budget.

Tariff reductions and removal of quantitative restrictions can be put in place by the stroke of a minister's or a legislature's pen. Money may flow in different directions because of these policy changes, but implementation itself costs nothing. However, implementation of customs reform, Trade Related-Aspects of Intellectual Property Rights (TRIPs), and so on will cost money to purchase equipment, train people, and establish a system of checks and balances. Questions of project design costs and of rates of return compared with alternative uses of capital are therefore relevant. A decision to give a concession on market access is based on what a trading partner will give in return. Exchanging reductions of trade barriers on this basis has worked—not because the decision process brings forward the relevant costs and benefits, but simply because it moves toward a good result. The same decision schema—comparing the market-access impacts given and received—is not the way investment decisions are usually made, and the Uruguay Round experience suggests that it does not lead to good investment decisions.

Customs Reform

Our review suggests that reform is needed and that reform will cost money. Do the Uruguay Round agreements correctly identify where developing countries' priorities should be, that is, *what* reforms should be made?

- Do the WTO agreements appropriately identify the problems faced by developing countries?
- Given the least developed countries' needs and their resource bases, do the agreements provide the most effective remedy?

¹The experiences we reviewed were in the more advanced developing countries. The costs could be higher in the least developed countries that begin below the required standards.

The WTO customs valuation agreement extends the Uruguay Round concern to control import restrictions by developing countries—bound *ad valorem* tariffs are not constraining if valuation is not constrained. But from the perspective of the least developed countries' need for customs reform, the WTO agreement provides neither an appropriate diagnosis nor an appropriate remedy.

The valuation process that the Uruguay Round agreement requires is one that complements customs systems in place in most of the advanced trading nations, including both developing and industrial countries. Their systems are based on familiarity with auditing techniques and generalized use of electronic information management—not only to process customs information but also to arm auditors with the information they need. Trade in these countries takes place in large lots, and duty rates are generally low. In this context, departure from routine practice is costly for traders relative to what is at stake in paying the duty. In poorer countries, incentives are different. At a duty rate of 50 percent, the duty on the number of television sets one person can transport on a bicycle-jitney can equal a year's wages.

Effective customs administration has both physical and administrative dimensions. The WTO agreement presumes that the physical dimensions are under control. In poorer countries they often are not. A World Bank project undertaken to increase trade among Eastern European countries by improving procedures at land crossings found that the local citizens assigned the highest priority to building bathrooms. Trucks wait 8 to 12 hours at crossings, but because there are no toilets for the drivers, the alleys and roadways are foul. Next priority: many of the crossings have no electricity or telephones.

Customs processes in poorer countries exhibit many interacting weaknesses—excessive procedures (international guidelines) that are not codified, ineffective provision for appeal, poorly trained officials, a civil service system that does not pay a living wage and depends on officials who receive side payments for performing their functions. Bert Cunningham, in assessing several least developed countries considering customs reform, observed that systems appeared to have evolved to maximize the number of steps and approvals—to create as many opportunities as possible for negotiation between traders and customs officials (Cunningham 1996). The Uruguay Round negotiations, however, paid attention only to customs valuation, ignoring the dimensions of customs reform, which is where the critical developing country problems exist.

The foregoing information comes from projects in poor countries that want to improve their customs processes. The Uruguay Round agreement addresses only customs valuation—perhaps an inch of the

whole yard of problems that these countries face. In most of the countries, to put the WTO-prescribed valuation system on the physical and administrative base that currently exists would make things worse, not better. Administratively, it would increase rather than decrease the potential for customs valuation to be negotiated rather than objectively determined. Physically, it would install computers in border posts without electricity and without telephone lines. For the poorer countries, the WTO customs valuation agreement provides an inappropriate diagnosis and an inappropriate remedy.

Intellectual Property Regulation

The WTO agreement on TRIPs covers the seven main areas of intellectual property: copyright, trademarks, geographical indications, industrial designs, patents, layout designs of integrated circuits, and undisclosed information including trade secrets. TRIPs also requires WTO members to provide for protecting plant varieties, either by patent or by an effective *sui generis* system such as the plant breeder's rights established in the International Union for the Protection of New Varieties of Plants convention.² In each area, the agreement specifies standards of protection that governments must provide and requires governments to provide procedures to enforce.

The minimum standards are similar for each of the areas. For patents they cover (1) what is patentable, (2) what rights flow to the owner of a patent (the government is required to prevent unauthorized persons from using, selling, or importing the patent, the patented process, the patented product, or the product or products directly made from the patented process), (3) what exceptions to those rights are permissible—for example, compulsory licensing may be required, (4) how long the protection lasts.

The enforcement provisions require that a member provide civil as well as criminal remedies for infringement of intellectual property rights. They also require members to provide means by which rights holders can obtain the cooperation of customs authorities to prevent imports of infringing goods.

²The TRIPs agreement provided the following transition periods:

- Industrial countries, until 1 January 1996
- Developing countries and transition economies, up to 1 January 2000
- Least developed countries, up to 1 January 2006—and may be extended on “duly motivated” request by a least developed country

Developing countries that now provide patent protection to processes and not to products, for example, in the food, chemical, and pharmaceutical sectors, can delay the application of the obligation to protect products up to 1 January 2005. Even here, governments must specify that inventions made between 1995 and 2004 will be able to gain patent protection after 1 January 2005.

The TRIPs agreement builds on standards expressed in relevant international conventions such as the Paris Convention for the Protection of Industrial Property and the Treaty on Intellectual Property in Respect of Integrated Circuits. TRIPs requires each WTO member to adhere to the provisions (with a few provisions excepted) of such international intellectual property rights conventions, whether or not the member is party to those conventions. This represents a major extension for many countries. For example, when TRIPs came into force, the treaty on integrated circuits had only nine signatories, only one of which had ratified it. Another example, the Rome Convention—which establishes rights of performers, producers of sound recordings, and broadcasters—has few signatories, particularly among developing countries. The TRIPs agreement creates an obligation on each member to provide the means through which a recording company from another member can attack unauthorized reproduction and sale of its products within the first; that is, a recording company located in Country A may use the legal mechanisms of Country B to attack unauthorized copying or sale by Country B citizens entirely within Country B.

The TRIPs standards are sometimes described as “minimum” standards, but they are minimum only in the sense that each member must provide at least the specified levels of protection and coverage. For perhaps every member, even the industrial countries, they represent an expansion of intellectual property rights in favor of intellectual property providers over users.

As with the customs valuation agreement, we found that the investments required for TRIPs implementation did not match the priorities revealed by actual developing country decisions. Generally, most countries have been at an advanced stage of development before they provided the mandated level of protection for producers of intellectual property. France, for example, introduced pharmaceutical patent laws in 1960, Germany in 1968, Japan in 1976, Switzerland in 1977, and Italy and Sweden in 1978 (Juma 1999: 18). One analyst described the coverage of TRIPs as “the standards of protection on which the industrial countries could agree among themselves” (Reichman 1998: 586). Again, for the poorer countries, the WTO agreement on intellectual property rights does not provide an appropriate diagnosis or an appropriate remedy regarding where these countries’ investment budgets should be allocated.

Because TRIPs builds on international conventions developed in large part by the industrial countries and on the enforcement practices they employ, the default mode for meeting the TRIPs obligations is for the developing countries to copy industrial country intellectual

property law. Although legal scholars point out that the agreement allows for the possibility of adopting intellectual property law that is friendlier to users and to second comers, they also point out that the benefit of the doubt is on the side of copying present industrial country approaches (see Reichman 1998). The mandate that the industrial countries have delivered through TRIPs is "Do it my way!" A developing country that opted to develop its own alternative would add to the cost of implementation the cost of developing that alternative plus the cost of defending it—in WTO's political and legal processes.

Sanitary and Phytosanitary Measures

The World Bank has assisted many countries in implementing sanitary and phytosanitary regulations. The projects cover a range of activities, among them, upgrading veterinary services, building or upgrading quarantine stations, certifying disease-free and pest-free zones, and providing staff and equipment for research aimed at reducing chemical residues in exported meat.

Bank projects supporting SPS systems have typically placed these measures in a general development context of ensuring food security, increasing agricultural productivity, and protecting health, rather than focusing on the narrower objective of meeting stringent requirements in export markets. None of the projects we reviewed listed meeting WTO requirements as one of its objectives, though several were built on the realization that diversification into higher value-added exports such as processed meats, seeds, and horticultural products required producers to meet more stringent quality control standards.

The SPS agreement elaborates on the provision in GATT Article XX that governments may restrict trade when necessary to protect human, animal, or plant life or health, provided that the measures (1) are not applied in a manner that unjustifiably discriminates between countries with the same conditions and (2) are not applied as a disguised restriction on trade.

The agreement specifies that SPS measures conforming to relevant international conventions³ are to be deemed necessary to protect human, animal, or plant health, and presumed consistent with the relevant parts of the SPS agreement and of Article 3.2 of the GATT. Industrial countries have been leaders in establishing these international conventions, the resulting conventions being for the most part generalizations of their practices and standards.

³The SPS agreement specifically recognizes the Codex Alimentarius Commission, the International Office of Epizootics, and the International Plant Protection Convention, including subsidiary and regional parts thereof.

The SPS agreement is less intrusive than TRIPs. TRIPs mandates the intellectual property rights regulations that a country applies in its domestic economy while SPS obligations concern only SPS measures that are applied at the border. The SPS agreement provides a basis for a country to defend the import-restricting measures that it applies (as consistent with the agreement) and to challenge through the WTO dispute settlement mechanism the restrictions other countries apply to its exports (as inconsistent with the agreement).

Implementation will be expensive. To gain acceptance for its meat, vegetables, and fruits in industrial country markets, Argentina spent more than \$80 million to achieve higher levels of plant and animal sanitation. Hungary spent more than \$40 million just to upgrade the level of sanitation of its slaughterhouses. Technical assistance provided by industrial countries has generally been tied to the interests of industrial country enterprises.

Deriving benefits for the local economy from the technical assistance that is supplied is an issue. A number of industrial country processed food companies have facilities in developing countries from which they export to their home countries; meeting home-country SPS standards has been built into the construction of these facilities. The next challenge is to pass the mastery of this technology to indigenous enterprises. Some technical assistance has been aimed at expanding industrial country exports. An African food scientist who had been invited to attend a training session in an industrial country remarked to me in conversation, "They want us to implement SPS so that we will import more chickens."

Uruguay Round Generated No Poor Country Ownership of the Rules

In the GATT/WTO political/legal system, the central organization has limited power to enforce. Unless a country has the "political will" to implement its obligations, the GATT/WTO legal mechanisms by themselves are unlikely to enforce meaningful implementation. Thus, national "ownership" of the rules is a necessary element in the functioning of such a system of rules. The members' participation in establishing the rules is an important part of building a solid sense of owning them. Although the Uruguay Round has been celebrated for the active participation of many developing countries, that participation was a small part of the current 109 developed country and transition economy WTO members. (If we include observers, many of whom are negotiating accession, the number of developing and

transition economies involved totals 144.) Active developing country participation in the technical negotiations was particularly limited.

Three factors are behind the lack of developing country ownership of their Uruguay Round obligations: (1) incomplete negotiating delegations; (2) the “do it my way” approach of the industrial country negotiators; and (3) creation of the WTO, which significantly changed the options that the developing countries faced.

The African Economic Research Consortium's evaluation found that Sub-Saharan African countries' participation in the rule-making exercises of the Uruguay Round was minimal. The reasons behind this are as follows: (1) Geneva delegations were small and lacked persons with the technical backgrounds needed to participate effectively.⁴ (2) Links between WTO delegations and the relevant agencies at home hardly existed, for example, health and agriculture ministries with negotiators on sanitary and phytosanitary standards, and a customs agency with the customs valuation negotiators. (3) Stakeholders, for example, the business community, were minimally involved.

This point has two related dimensions—content and attitude. The content of industrial country proposals on customs valuation, intellectual property rights, and sanitary and phytosanitary measures was very much modeled on their own systems and institutions, which were already in place. SPS and TRIPs agreements allow for the possibility of approving developing country indigenous systems, but gaining approval would be expensive. For example, the basic metric of SPS implementation is risk assessment—the risk of establishing or spreading a disease or pest. International conventions deal with both the scientific method for measuring risk and the appropriate levels for regulation. A country may adopt other methods or other levels, but in applying such standards at the border, the WTO agreement places on the country the burden of demonstrating their scientific merit and appropriateness.

⁴When the Uruguay Round began in 1987, the GATT/WTO members totaled 65 developing countries, 20 of which did not have delegations in Geneva. Of the 20, 15 were represented from embassies in other European cities, and 5 by delegations based in their national capitals. Furthermore, developing country delegations were notably smaller than those of the industrial countries. The European Union had in Geneva a delegation of 10. EU member states' delegations included an additional 57 persons. The U.S. delegation numbered 10, the Japanese, 15. Only 12 developing countries had delegations of more than 3 persons. The larger ones, Korea, Mexico, and Tanzania, had 7 each; Brazil and Indonesia, 6 each; Thailand, Hong Kong, and Egypt, 5 each. Of the 48 least developed countries, 29 are WTO members, but only 11 of these maintain delegations in Geneva. As of January 1999, 6 least developed countries were negotiating accession to the WTO; another 6 were observers who were not negotiating accession.

Regarding attitude, the record of negotiations over customs valuation shows that industrial country negotiators were unfamiliar with and were unwilling to learn the conditions under which customs officials in developing countries operated. U.S. and European Union differences on customs valuation were resolved in part by the EU customs officials making a four-week study tour of Canada and the United States (at EU expense). None of the industrial countries supported a proposal to organize in Geneva a workshop (under the GATT technical assistance budget) that would have included both developing and industrial country customs technicians. Vinod Rege, who served on the GATT Secretariat staff to support these negotiations, concluded as follows:

In hindsight, it would seem that if the EC officials who came back from the visit to the U.S. customs services, satisfied that the U.S. valuation system was not after all as arbitrary as they had thought, had also visited the customs services in a few developing countries, there would have been a better appreciation of the views of the developing countries' negotiators. This would have facilitated more informed communication and, thus, created a basis for more fruitful dialogue. (Rege 1999: 74)

The WTO Changed Options

Because the Tokyo Round codes were part of the GATT, the GATT nondiscrimination obligation (Article I) required that signatories to any code apply the code in their dealings with all GATT contracting parties, not just with other signatories—that is, nonsignatories were entitled to the benefits (in the mercantilist sense) of a code without accepting the obligations. The agreement to establish the WTO provided an all-or-nothing option, it did not allow a country to accept some of the constituent agreements (e.g., on customs valuation or intellectual property rights) and reject others. Industrial country negotiators, who might have been focused on getting a select list of about 20 developing countries to accept the new disciplines on customs valuation or on intellectual property, found that they now had a way to insist that all of them accept. For the developing country negotiators, the diplomatic value of becoming a WTO member weighed heavily. In many countries the obligations that came with it were not carefully considered. Olawale Ogunkola concluded that “the ratification of the agreement and the single undertaking clause made the implementation of the agreement almost non-negotiable” (Ogunkola 1999).

An Overly Legal View of How the GATT/WTO System Works

I suspect, but have not documented, that industrial country negotiators may have misread the historical record of how effective creating

legal obligations has been in forcing changes of national policies. The following, from an industrial country document on trade facilitation, illustrates what I consider an incorrect view of causation:

To succeed . . . requires political commitment. . . . The creation in WTO of basic rules . . . will underline and secure the political commitment of WTO Members.

The reverse, that political commitment can lead to the creation and observance of meaningful rules, seems more consistent with the historical record. Robert Hudec, in a review of the first three years of the WTO dispute settlement mechanism, a review that drew on Hudec's quarter century as an analyst of GATT/WTO dispute settlement, concluded as follows:

A third lesson suggested by the GATT's experience is that political will is really more important than rigorously binding procedures—that strong procedures by themselves are not likely to make a legal system very effective if they do not have sufficient political will behind them. . . . When we ask whether or not the new system will work, therefore, we have to begin by asking what kind of political will stands behind it. The current fascination with the novel WTO procedures tends to obscure the importance of this first and most important condition of success. (Hudec 1999: 11)

The TRIPs, customs valuation, and SPS agreements and several others suggest that industrial country members furnish technical assistance to developing country members that request it. This provision, however, is not a binding commitment. In effect, the developing countries have taken on bound commitments to implement in exchange for unbound commitments of assistance to implement.

Without ownership (political commitment) among the members, WTO rules are not likely to be implemented. Imposing the rules in the “Got ya!” fashion of the Uruguay Round negotiations did not provide that ownership. More appropriate than a five-year implementation period might have been a five-year cooling-off period.

Conclusions

The WTO has 109 developing and transition economy members. As of January 1, 2000, 80 or 90 of them are in violation of the SPS, customs valuation, and TRIPs agreements. (For the 29 least developed country WTO members, the TRIPs deadline is 2005). Implementing their obligations would require the least developed countries to invest in buildings, equipment, training, and so forth that would cost each of them \$150 million—for many of the least developed countries this represents a full year's development budget.

Would this money be well spent? For perhaps 20 of them—mostly the developing and transition economies that meet their implementation deadlines—it might well be. For the other 80 or 90, it would be a bad investment. Basic education, particularly for women and girls, would have much more attractive rate-of-return numbers.

That does not imply that no reform is needed to improve developing countries' customs procedures, food safety systems, and systems for generating and for using intellectual property. Developing countries are willing to borrow money to finance improvements in these areas. Thus, it is evident that they themselves see a need for reform. "Not to reform" is an untenable option. Questions about implementation are questions of priorities, of method, and of ownership-motivation.

We should be careful not to be lulled into the ethic of a reciprocal negotiation in which delay, in itself, is a victory. As I have already stated, the less developed economies need improvements in the areas that are new to the WTO—to delay these improvements is to lengthen the time that the people in these countries remain poor. Time will be needed for implementation; but implementation periods should be based on considerations of the appropriate priorities for the available development budget and on the engineering requirements to accomplish the required construction. Improvements should not be handed out as a second prize in a tough negotiation.

Arguments that GATT obligations (trade liberalization) are good medicine for industrial but not for developing countries are incorrect. The burden of implementation here is a political one, not an economic one. But many countries have now undertaken other WTO legal obligations that are not in their interests to implement—implementation makes neither domestic, political, nor economic sense.

My objectives in this article have been to illustrate that problems exist, to call attention particularly to the amount of money at stake, and to suggest that spending it would not make economic sense. For the GATT, an economist could in good faith urge that a country—industrial or developing—overcome opposing domestic politics and meet its obligations. For the WTO, one cannot.

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SPEAKING ABOUT TRADE TO THE OPEN-MINDED SKEPTIC

Russell Roberts

In the United States, free trade receives nearly unanimous support from economists but remains quite a controversial issue among the public. That gap suggests there is a long way to go in making the case for free trade. And yet, a number of signs suggest that the situation is brighter than it appears.

Presidential candidates from either party who have made protectionism their signature issue (see Gephardt and Buchanan) have fared poorly. Perot made a splash but trade was just one of his issues. The novelty of his act has faded. Then there is the indirect but tangible proof, the long-term trend toward free trade as evidenced by the success of previous rounds of the General Agreement on Tariffs and Trade and the unmistakable trend toward lower tariff rates as seen in Figure 1: by 1996, the average import faced duties of only 2.5 percent. If the average American is hostile to free trade, the political process does not appear to reflect it.

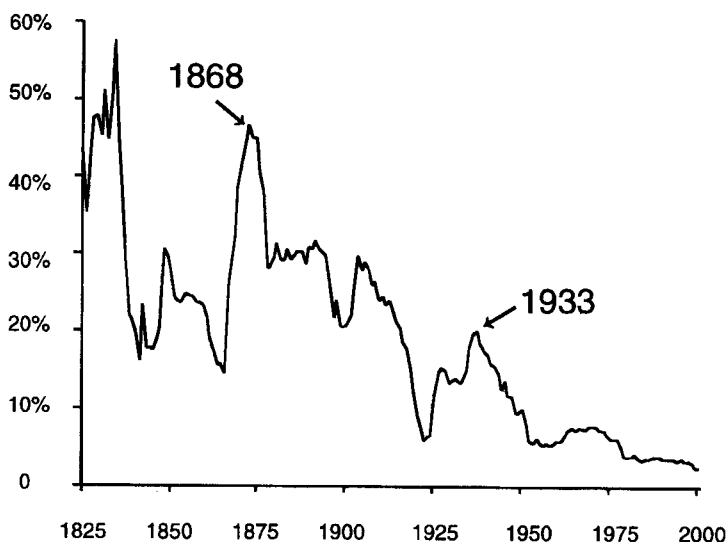
Nevertheless, there are two discouraging trends. First, Congress and the president are reluctant to act quickly and decisively when trade issues arise. Since the North American Free Trade Agreement (NAFTA), no movement toward freer trade has come easy. Trade agreements that were once nonissues have become political minefields. The explosiveness of trade issues is particularly alarming given the healthy state of the economy. When the economy falters, the demand for protectionism will be that much stronger. The recent failure of the World Trade Organization meetings in Seattle to advance an agenda for new negotiations is the latest discouraging development.

Second, nontariff barriers, particularly dumping penalties, are used to advance the cause of protectionism. So the trend in tariff rates is not quite as rosy as it seems.

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Figure 1
AVERAGE U.S. TARIFF RATE, 1821–1996



Sources: Historical Statistics of the United States; Statistical Abstract of the United States.

Is the glass at least half full? Probably. But we can always do better in explaining the basic economics of trade to the American people. Our best opportunity for improvement lies with the open-minded skeptic. I once debated NAFTA with a union spokesman at a local public library event. The debate did not go well. The spokesman claimed that all Mexicans live in mud huts and make 50¢ a year. His estimate of the manufacturing wage in the United States was half of the true value. Worst of all, numerous members of the audience were his family members who hooted and mocked anything I said.

One of the reasons I fared poorly was that I thought the point of the debate was to convince my opponent that free trade is good. In fact, the union spokesman was not my audience. His family members were not my audience. I had no chance of convincing them; their minds were made up. My audience was the woman in the crowd who was worried about foreign goods but was open-minded enough to hear me out. Call her the open-minded skeptic. I would have had a chance to persuade her if I had tailored my comments accordingly.

This article suggests ways of communicating good economics to the open-minded skeptic. I have four suggestions: (1) Don't lie. (2) Speak plainly. (3) Illuminate the unseen. (4) Bring trade to life.

Don't Lie

Trade is a complicated matter. Because of its complexity, we tend to simplify when making the case for free trade. Unfortunately, that tendency sometimes leads to lying, or half-truths. Lying is a poor way to win friends and influence people, yet in Washington the dominant argument for free trade is that it creates jobs. That is not exactly a lie, but it is terrible economics. The argument maintains that free trade means greater exports and that every \$1 billion of exports creates 20,000 new jobs.

This numerical impact of exports on job growth is based on Department of Commerce data that try to count the number of jobs that involve exports. The Office of the U.S. Trade Representative (USTR) takes the dollar value of exports, measured in billions, and divides it by the estimated number of jobs. This number is then used by policy advocates as a kind of export multiplier. While the Department of Commerce and the USTR talk about the number of jobs “supported” by exports or that “depend” on exports, many free trade advocates around Washington talk about the number of jobs “created” by exports. The number (and variations on it) is invoked by reputable economists and reputable think tanks. (I will not drop names here, but if you are curious, get out your favorite search engine and have a look around.)

Arguing that exports create jobs is bad economics because it makes exports sound as if they have a life of their own, independent of imports and capital flows. It implies that if the United States could increase exports by a billion dollars, 20,000 new jobs could be created here at home. Neither statement is true or has any real meaning. In reality, the number of jobs in the American economy is roughly independent of trade, either exports or imports.

The best way to see the emptiness of the slogan “trade is good because it creates jobs” is to look at the debate over NAFTA. At the center of the debate was whether NAFTA would create or destroy jobs. Proponents said NAFTA would increase U.S. exports and thereby create jobs. Opponents said NAFTA would increase imports from Mexico and thereby destroy jobs.

Actually, we do not trade with Mexico to create jobs. We trade with Mexico because there are some things Mexicans can make more cheaply and effectively than we can. To get those goods and services we have to trade things (goods, services, assets, or currency) that Mexicans value.

In hindsight the debate was absurd, but incredibly, it still continues. Fans of NAFTA argue that it has created jobs because our exports have increased. Anti-NAFTA folks complain that since NAFTA was

put in place, our trade balance with Mexico has gone negative. That means imports exceed exports. And that means (because of the job multiplier that people like to bandy about) that every billion dollars of the trade deficit with Mexico costs the United States 20,000 new jobs. Both sides go out and actually try to count the jobs gained and lost. Each side adds up the job losses from companies that have closed factories and relocated to Mexico or companies that have opened or expanded factories that sell to Mexico.

But this is the wrong way to count the employment impact of trade with Mexico. To see why, suppose Mexico, out of sheer goodness, decides to give away its exports for nothing to the United States. Suppose Mexico picks a particular industry's product, metalworking equipment, to be its only export. As a result, the U.S. metalworking equipment industry, unable to compete with its altruistic Mexican counterparts, has to shut down all of its factories. What would be the effect on U.S. jobs of this Mexican benevolence?

Using the naive method of counting jobs produced or lost in industries directly related to the United States and Mexico, we would lose the jobs in the U.S. metalworking equipment factories. Because the Mexicans are giving away the metalworking equipment for nothing, let us assume there will be no Mexican demand for U.S. imports and, therefore, no U.S. factories expanding production to Mexico.

The lost metalworking jobs in the United States would be a terribly misleading measure of the impact on the economy and on the labor market of the Mexican gift. If our metalworking industry shut down, the capital and resources that feed that industry would be free to go elsewhere to create new opportunities. The laid-off workers would look for new jobs. Some would take a long time to find them. Some would not find new jobs. Others would find new jobs, some of which would even pay well. As the laid-off workers looked for opportunities and as the capital flowed to new uses, all kinds of jobs would be created that were not directly related to metalworking. So looking just at expansion and contraction related to Mexico is a grossly inaccurate way to account for the job impact.

Counting up lost jobs directly related to Mexican imports and exports is bad economics. But it is worse public policy; it enables the enemies of free trade to demonize trade deficits as job destroyers by invoking the Commerce Department number.

The 19th century French economist and writer Frederic Bastiat understood the irrelevance of the trade balance for economic health. Here is a modernized example of one of his arguments against balanced trade. If you want balanced trade, build a factory on the shores of California. Load ships with the factory's output and send them off to

Asia. Before the ships actually get there and before there are any customers for any of the goods being carried, sink the cargo in international waters and have the ships return for more cargo. The cargo of the ships will be classified as exports. So exports will increase and our trade deficit will get smaller.

Bastiat's example illustrates the foolishness of focusing on the trade deficit. And it also shows the foolishness of the job accounting measures that look at export and import employment alone. Will the fake factory in California increase employment in the United States? It will increase employment in that wasteful factory in California, making it appear that U.S. employment has increased. But those workers will have to come from somewhere. Many, if not all of them, will quit other jobs to come work in the factory. To attract them, the fake factory will have to offer a good enough package of wages and benefits to draw workers away from other industries and factories. It will appear that the "export" jobs created by the fake factory pay more than other jobs in the same industry. It will appear that the factory has created jobs. But both conclusions will be false. And measuring the true impact will be impossible unless we know each industry in which those workers used to work or would have worked in the absence of the factory.

Trade determines the kind of jobs we have in the United States, not the total number. This is not a slogan to go to war for, nor does it compare with the inspiring "Trade creates jobs." But at least it is true. Below, I will attempt to make the tepid job-composition argument into something more inspiring.

Finally, there is a variation on lying that is almost as dangerous as lying. That is the whitewash. Free trade proponents commonly claim that trade is good for everybody. Free trade is not good for everybody. The transition to free trade is not good for everybody. Free trade harms some people and can harm them a great deal. Ignoring that harm in the name of advancing a free trade agenda is counterproductive.

Speak Plainly

When trying to explain the economics of trade issues, the most persuasive arguments are the ones that noneconomists can actually understand. A lot of economists like to invoke efficiency when making the case for free trade. Invoking efficiency makes the economy sound like the engine of a car, or a complicated distribution system in a warehouse. It is a poor metaphor, it is incomprehensible to noneconomists, and it is morally deceptive as well.

For years, when I taught microeconomics to undergraduates, I always discussed the distortion caused by tariffs. I used nice pictures with triangles of deadweight loss. By the end of class, students believed that all kinds of well-meaning policies had significant costs. But if you asked them why such and such a law was costly they would say, "It's inefficient." And if you asked them why that was bad, most students would parrot back the mantra: "Some people could be made better off without making others worse off." Eventually, I realized that if I wanted my students to advance beyond bird status, I would have to explain something about the effects of trade beyond efficiency, or at least have them understand how inefficiency affects our everyday lives.

Efficiency arguments have an implicit moral dimension that is misleading. When a tariff is removed, the benefits to consumers outweigh the losses to suppliers. As is often explained, the winners gain enough to compensate the losers for their losses and are still better off after the compensation. Of course, the compensation never takes place (though trade adjustment assistance is a step in that direction). More important, efficiency analysis is static. It ignores the transition cost of moving to the new equilibrium for workers who lose their jobs. These costs are typically the ones skeptics are most concerned about.

Efficiency fails to persuade the skeptic. But it also confuses. The argument paints proponents of free trade as nothing more than soulless technocrats who care only about the smooth performance of the economy rather than the people in it.

Illuminate the Unseen

When explaining the economics of trade policy, it is important not to lie and not to use economic jargon. I now turn to some more positive advice. When a steel mill closes, the misery is obvious and leads the nightly news. When a factory does not get built because we protected the steel industry with a quota or a tariff, no one notices because it cannot be seen. It cannot be covered on the news. The people who will not be able to work in the factory because it does not get built are not aware of the lost opportunity.

If we are going to make the effects of trade policy tangible, we have to do a better job of illuminating what Bastiat called the unseen. The fundamental challenge at the heart of trade policy is that the costs are visible while the benefits are harder to see. Here are a few ways to make the unseen impact of free trade and protectionism visible.

In the case of the steel mill, there are two ways to make steel. There is the direct way we are all familiar with: you build a steel factory, add people, machines, and raw materials, and steel is the

result. Then there is the roundabout way: you build something that the Japanese want and ship it to Japan in exchange for steel. In one case, you have steelworkers making steel. In the other, you have Boeing workers or Merck workers or Disney workers making products we export to Japan in exchange for steel. We do not see this exchange because it is masked by the currency flows that make it happen, or because sometimes we export the Boeing plane to Germany and Germany exports something to Japan.

If we let the steel mill die, the capital and talent and raw materials are free to flow elsewhere. They will flow to Boeing and Merck and Disney, and they will also flow to unknown, unseen uses that we cannot predict in advance. This is another example of the dynamism of the labor market discussed earlier. Critics of free trade demand to know how we can be sure that new jobs will be created. Looking to the past can offer some comfort and illuminate the unseen.

At the beginning of the 20th century, total employment in the United States was about 26 million. About 11 million of that total, or more than 40 percent, were agricultural jobs. Over the last 100 years, agricultural employment has shrunk to just over 3 million, or less than 3 percent of total employment. If you had told a farmer in 1900 that over the next 100 years employment in agriculture would go from more than 40 percent of economy-wide employment to less than 3 percent, he would have been horrified. What could possibly replace all of those jobs? Surely, there would be massive unemployment and famine.

It turns out that his fear would have been misplaced. While farm jobs were getting scarce, we managed to create over 100 million new jobs in the past century. Those agricultural jobs were replaced with other kinds of jobs, jobs that people preferred over working in the fields at five in the morning and slopping the hogs.

Talking to a farmer in 1900, we would have had no way of predicting what kind of jobs would be created to replace the agricultural jobs that would not have been created in the first place. With the benefit of hindsight, we can see that millions of jobs were created as U.S. resources were devoted to activities other than farming. The farmer's skepticism would have been misplaced. That error may provide comfort to today's skeptic who is concerned about the same issue of future job growth.

Bring Trade to Life

It is not enough to illuminate the unseen. To have trade make an impact on people, we have to bring trade to life. The common way

trade advocates try to make trade come to life is a variation on the Commerce Department job creation argument: "Trade is good because your job depends on it. You work in an industry that sells to foreigners. Exports help pay your salary." Just as with the "exports creates jobs" argument, people are encouraged to think that the best trade policy is one that opens markets abroad at any cost. It gives people the uneasy feeling that they are somehow dependent on foreign consumers. It also teaches the wrong lesson that the goal of trade is exports.

Another argument is commonly used to make people think that they have a stake in trade: free trade leads to lower prices. People like low prices. But low prices alone will not always convince the skeptic. The impact of low prices may be dwarfed by other effects that the skeptic is rightfully concerned about.

For example, a large proportion of America's broom production comes from a few small towns in Illinois. One of them, Arcola, population 2,700, is the home of the Libman Broom Company, a major producer of U.S. brooms and one of the top two employers in town. Arcola was the poster child for opponents of NAFTA. Over time, NAFTA lowers tariffs on brooms from more than 32 percent in 1994 to zero. Because of the decreased tariff rates, U.S. broom companies will have trouble competing with Mexican broom companies. A lot of broom jobs, maybe all of them, are going to end up in Mexico rather than in Arcola.

Is it worth destroying the town of Arcola so Americans can have cheaper brooms? For most Americans, the answer to this question is no. You can argue that it is the wrong question. But it does not matter. Free trade can produce heartrending results. They may be few and far between. There may be good reasons for tolerating these results. But if we cannot articulate the economics of why these results are worth bearing, then we are handicapped in explaining the full impact of free trade. To convince the open-minded skeptic, we have to go beyond efficiency and beyond the pocketbook and speak to the heart in the same way the opponents of free trade do. And we must speak to the heart in a way that shows people the underlying economics of trade.

The people of Arcola may suffer because of NAFTA; there is more at stake than just cheap brooms. Somewhere in Arcola there is a high school girl whose parents work in that broom factory. She can stay in high school, go on to college, and begin a career. Another option is to stay in Arcola, maybe finish high school, maybe not, and go work in the broom factory with her parents.

NAFTA destroys one of those options. Let us assume that because of the lower tariffs on brooms, Mexican brooms push U.S. brooms off the shelves and the Arcola broom factory closes. That high school girl and her classmates will have lost an option. They will be pushed out into the world. Most of them will choose to leave Arcola, and Arcola in 2010 will struggle and do poorly.

That girl's parents are going to have a tough time. But is NAFTA good for that girl? A simple answer might be that if she had planned to work at the factory, she would be worse off; if she planned to leave the town anyway, losing the factory would not matter. But the simple answer is wrong. Because of NAFTA and free trade generally, we will import some things that we used to make for ourselves. That will enable capital and resources and energy and know-how to flow into other uses. New opportunities will be created.

The girl who enters the world without a broom factory in Arcola could inherit a different world outside of Arcola because we have the courage to let Arcola suffer. That world will be designed around the skills and aspirations of her generation. That world will let the girl express herself in ways she might never have done in the broom factory. The hardship of her parents will pose challenges for her and her generation. But like every generation, many will overcome those challenges in special ways to thrive in the new economy.

What ways will those be? We have no way of knowing. I only know that when I speak with high school students, they rarely speak of working in the same jobs as their parents. Free trade enables those students to achieve their own dreams by letting capital and skills accumulate to serve new ends, new markets, and new opportunities.

And Arcola? The Arcola of the future may look rundown, but its looks fail to tell us the true effect of free trade on the town. To understand the impact of free trade, we would have to do the mental experiment of bringing back all of the children that left town and prospered elsewhere. They will not be seen in Arcola's future struggles. But to assess the true impact of trade on Arcola, we have to illuminate the fate of the next generation that will choose to live elsewhere and who, because of free trade, will be able to find new opportunities elsewhere and thrive.¹

¹There is a postscript (or maybe a prescript) to the Arcola story. I called the Arcola Chamber of Commerce recently to find out how Libman Broom is doing. To my surprise, they're *expanding*. I learned that a Presidential Order of 1996 delayed the implementation of the broom tariff reduction. Presumably broom tariffs will eventually fall, and Arcola will have to cope with change.

Trade determines the kinds of jobs we have in this country, not the total number. As mentioned earlier, this is not exactly a romantic slogan to go to the barricades for. But it is true, and when fleshed out with a little bit of analysis of the unseen, it can begin to make a case for free trade that may speak to the open-minded skeptic.

Conclusion

Free trade is an issue that enjoys almost unanimous support among economists. The opponents of free trade are typically noneconomists with a pecuniary stake in protectionism. The opponents know how to tell anti-free-trade stories that pull on the heartstrings. We economists need our own stories. We need stories that capture the basic economics of trade, stories that inspire, that illuminate the unseen, and that speak in the language of everyday Americans. We have won the debate in theory. To win the debate in practice, we have to find better ways of bringing the theory to life, making it sing, and getting it heard.

THE TRADE DEBATE'S UNLEVEL PLAYING FIELD

Ronald A. Cass

Americans have a general understanding of trade. We understand that trade is good. We may not be exactly sure what “free trade” is, but we have a sense that it is mostly a good thing.

Unfortunately, the instinctive appreciation that trade is beneficial is coupled with a woeful ignorance of *why* this is so. If you listen to politicians, you will quickly see that although *trade* is good, *imports* are bad. What’s good about trade, so far as public discourse goes, is that it gives us the ability to export our goods to others. More exports, we are told, means more money. Jobs in “export industries” pay more than jobs in other parts of the economy. Exports drive the growth of our economy. But imports take bread out of Americans’ mouths, take money out of the economy, pile up debts to other nations, and leave us dependent on others. Naturally, we have to permit some imports if we are to persuade others to admit our exports. But we must be on guard against the abuse of our goodwill by nations such as—the target here depends on when the discussion takes place—Japan or China or whatever nation we fear will just keep exporting to us until everything is made there and all we do here is flip burgers.

Selling the Benefits of Imports

Told in this way, which is pretty much the norm, every aspect of the normal trade story is somewhere between misleading and completely backwards. Imports, in fact, are not an evil that must be tolerated to permit exports. Imports are what is wonderful about trade. Imports provide us choices we wouldn’t have without trade, things that are made better, for less money, more suited to our tastes than

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domestic alternatives (at least better suited to some tastes). And exports help pay for them. It is like having money from work to go buy things at the mall. We want to have more choices of better things to buy. The money we buy them with comes from work, but we don't buy things so that people will let us work—it is just exactly the reverse. We *want* imports, and exports help us get them.

It might be easier for people to understand trade by starting with a homelier example. We don't each make our own clothes, grow our own food, build our own homes and cars and computers. Why? Because we can't do it as well or at as low a price. We let others specialize in what they do best while we specialize in what we do best. Everyone can understand that. They can grasp that the same reason explains why we don't limit our economic reach to only our family or only our neighborhood or only our town or even only our state—none of these allows us access to the range of goods and services we want, to the best goods at the best prices. By circumscribing the range of people and products we have access to, we inevitably cut off possibilities that will enhance our choices and increase our wealth and our welfare. That reasoning extends to international trade as well (see Bhagwati and Srinivasan 1983; Cass and Haring 1998; Corden 1974; Samuelson 1987).

The claims about returns to export industries, although plausibly connected to increased welfare in some (highly unusual) circumstances, generally add nothing to this picture. In an unconstrained market, export industries (those that export a large value of goods, absolute or relative to overall production, or that export a large volume of goods) will not have higher returns than import industries. A difference in wages most likely is the result of defective measurement, although there are other possibilities. Perhaps we tend to export goods in which there are strong economies of scale and transitory abnormal returns to specialized resources (labor included), a possibility consistent with an advantage in producing capital-intensive goods. But competition will erode any differential over time. What is good about trade traces back to its creation of wealth through allowing better, more efficient production and access to a more valuable set of consumption opportunities. Other explanations at best fit marginal cases.

Enough about this is understood to keep anti-trade forces from seriously undermining the framework that promotes open trade. The legal regime that governs trade—globally and at home—is full of provisions that are difficult to defend as consistent with sound economics, provisions that provide opportunities to protect inefficient producers, reduce consumer welfare and national wealth, support senescent industries, and impose costs on our most promising and productive

industries (see Baldwin 1985; Bhagwati 1988; Destler 1986; Goldstein 1986; Tumlin 1985). But after all is said and done, that framework has kept trade expanding globally and at home, in absolute terms and as a proportion of the U.S. economy. The figures on trade are impressive. Growth in the value of trade over the past 50 years has increased at a rate substantially above the rise of world gross domestic product (GDP) (GATT 1994; Salvatore 1993). In the United States, two-way trade grew ninefold in real terms over the past 30 years, with U.S. trade now measured in the trillions of dollars, amounting to one-quarter of the U.S. GDP (Council of Economic Advisers 1995; Weinberg 1995). Average citizens do not know any of this, but they experience the growth in trade and its benefit to the economy in many ways—in access to Japanese cars, to French wines, to German kitchen appliances, to an array of fruits and vegetables that would have been unavailable much of the year and outrageously expensive when found. A vague perception of trade's benefits may help explain the failure of anti-trade forces to generate more political clout. Hardcore trade troglodytes—Ross Perot and Pat Buchanan stand out on this score—gain headlines, but they do not win enough votes to change trade policy. Yet, these avatars of autarky and their allies make progress difficult but not enough to put the direction of trade decisions in doubt. The public might have a strong suspicion that open markets are generally good, but when someone speaks out in favor of keeping markets open to imports—much less making our markets *more* open—most folks react without much enthusiasm. The typical reaction, when favorable, is “We’ve got to do this, even if it’s painful,” not “Drinks are on the house.” Why? And what can we do about it?

An Uphill Battle for Free Trade

The long-understood explanation for public skepticism about free trade traces to the asymmetry between pro-trade and anti-trade interests on three grounds: *visibility*, *accessibility*, and *intensity*. These asymmetries pose both educational and political challenges.

Look first at *visibility*. Anti-trade interests are supported by anecdotes about job losses identified with named individuals, all of them living here, our friends and neighbors. When trade is blamed for the demise of a domestic operation, there is a picture to show, a name to identify with the story. The building that two years ago hummed with productive activity now is idle. We made shoes there; now we buy shoes made in Thailand, Malaysia, the Philippines, China, or some other *foreign* place.

Pro-trade interests speak of the gains that are made because we can export to other nations, but that argument has no strong visual appeal. We can see goods piled at the dock, but the picture lacks the clarity of the shuttered factory. Worse, pro-trade interests are tied to *future* gains, to expansions that will come in your business or mine. And worse yet, the interests in trade depend on gains to producers from access to better, cheaper components, to a fuller product line, or gains to consumer welfare from greater choice, lower prices, and better products. None of these benefits presents itself in an obvious, visible manner. In the battle of images, the moving trucks carrying folks away and the chained gates left behind win.

Anti-trade forces have an advantage as well on grounds of *accessibility*. The visibility moral is that pictures beat words, stories beat anecdotes. But the related asymmetry exacerbates this problem. Not only are the stories of job losses easier to present in pictures than job gains or other advantages of trade, even the analytical connection between action and effect is more readily appreciated from the anti-trade perspective than from the pro-trade vantage. The anti-trade story is simple. Competition from imports (which in this story are usually labeled “foreign goods”) makes it more difficult for a domestic company to earn money. When a company cannot earn as much money, it must pay its workers less or have fewer workers or produce less or produce elsewhere. That’s the downside of competition. People around the world can understand that story. And in high-wage nations such as the United States, people also see that workers elsewhere in the world are willing to work for wages far below those acceptable here. If there is no reason that those workers cannot produce what you do now—because they are less skilled, for example, at critical tasks—there is ample reason to fear competition from them.

The argument for open trade is not so evident. It depends on understanding effects that are more diffuse, that must largely be taken on faith. The reason the company cannot compete with a foreign company is not that the foreign workers earn lower wages—we don’t, after all, fear losing jobs to Bangladesh and Burundi. It is because the foreign workers can, all things considered, do a particular set of tasks at lower cost. That is not the same thing as simply getting a lower wage. Wages tend to be productivity adjusted, both within nations and across borders, as a general proposition. Mexican workers who earn on average one-fifth as much as their U.S. counterparts are also on average only one-fifth as productive. For some types of production, the specialized skill of a U.S. worker paid far more has greater value than the wage differential between that worker and a foreign worker. High-wage economies remain strong as communica-

tions and transportation costs decline, making dispersed production and trade more economical. But the concepts of comparative advantage, of price equilibration across markets, and of Stolper-Samuelson effects are not so readily understood as the syllogism: high costs mean high prices; high prices mean lower sales; lower sales mean less money. The advantages of allowing less productive uses of resources, including human resources, to be priced out of the market so that the resources can be redeployed to more productive uses are readily comprehended by economists, less so by people who identify with the human resources that will need to be redeployed.

The final asymmetry, in *intensity*, runs in the same direction and increases the likelihood that the anti-trade story will be told—and will be told with a passion that prompts action. Investment in the anti-trade story is apt to be on behalf of producers who have specialized in a particular product and cannot expect to receive similar returns from a different line of work, especially if the current enterprise has been protected from competition (by regulatory barriers, by high transportation costs, by economies of scale that are large over some domain, and so on). In other words, the anti-trade line is pushed by folks who stand to lose a lot personally from the increased competition that trade brings. They have reason to be angry, to invest a great deal of time, energy, and passion in complaining about imports that compete with their products, trying to prevent friends from buying those imports, supporting lobbying efforts to constrain imports, and voting against candidates who favor trade liberalization. And that passion and those investments will influence others who have less reason to think hard about these issues.

On the other side, the consumer interest while maximal *in the aggregate* is minimal in intensity on the subject of free trade. Each consumer benefits marginally from better choices and prices on each of a host of items. That will account for less of each individual's budget line—financial or psychological—than the amount at stake when the individual responds in his capacity as a producer, not a consumer. As Professor Elmer Schattschneider (1935) recognized 65 years ago, we can expect little concerted activity from a group whose interest in the subject is so utterly lacking in intensity.

More intense interest in expanded trade comes from three sources. One is the business that depends on imports. Retail businesses, especially those competing through discounted prices, have strong incentives to support liberal trade. So do businesses connected directly with trade flows, such as container businesses, shipping businesses, dock facilities, and the like. Some financial services businesses also fit into this category, since transactions associated with increased trade

can substantially boost their expected returns. Similarly, businesses that use a critical input to production that is not produced domestically, or is not available from domestic sources at comparable quality or price as a foreign source, will support liberal trade. This is particularly true if the business competes head-to-head with a foreign rival that has ready access to the cheaper or better input. Caterpillar, which uses steel as a prime input to its production of heavy construction equipment and faces competition from rivals in Japan, has been a convincing promoter of pro-trade initiatives.

A second source of pro-trade interest has been businesses that see open trade—including openness to imports—as critical to developing a market advantage dependent on greater export opportunities. These often are vocal businesses: the film and television entertainment industries, some agricultural interests, producers of some transportation equipment (largely in the aircraft industry), and producers of some computer and telecommunications equipment (largely at the high end of those industries).

The third source of pro-trade interest has been the coterie of foreign businesses, foreign-related businesses, and domestic businesses with substantial foreign outposts that benefit directly from open trade through rationalization of their production resources.

Of these interests, the third source is often the most intensely interested but is generally disabled from participating too visibly in political debate. About one-half of U.S. two-way trade is intracorporate. Much of that trade benefits a firm most Americans would consider a U.S. firm (even if the firm's parent is English or Dutch). But much of that trade also benefits a firm that generally would be considered *foreign*. Even if Honda of Marysville, Ohio, or Nissan of Smyrna, Tennessee, adds considerable domestic value to whatever portion of their product arrives as imported parts, politicians will listen to their importunings with a different ear than they will entreaties from Ford or General Motors.

This leaves the leadership of pro-trade forces in the hands of the first two groups. The export-oriented groups will have little interest in exposing the benefits of imports to domestic welfare. Their interests are a better fit with the common view of politicians—that exports are good and imports at best a necessary evil, the quid pro quo for exports. That view makes it more important to emphasize just how good exports are, since they must be very good to justify allowing imports. But the exporters benefit from potential preferential treatment—treatment that gives them a competitive advantage in export markets—if they play this hand right.

So we ultimately depend on businesses that have a strong interest in imports as inputs to push the case for trade. Each of these businesses has good reason to want to do so. However, none of them will have as intense an interest in promoting imports as an import-competing business might have in protesting them. The output of the import-competing business represents the value of everything that goes into it, and imports compete with that, putting that value at risk. The import-reliant business also has an output, often one it would prefer to protect from competition, but the import makes up only a portion of the business's output value. General Motors, like Caterpillar, uses steel as an input and would benefit from reduced impediments to steel imports. But its greater interest lies in protecting its outputs—automobiles—from competition. The import-reliant business will not always subordinate its interest as producer to its interest as consumer, but the edge in intensity will tend to go to the import-resistant side.

So, what is to be done?

Educating the Public on Trade

At bottom, the answer must lie in education. Education must be the political analogue to “location” in real estate. And the focus must be substantially on public education, not merely on education of particular decisionmakers.

Success in public education is necessary both to *create* a more sympathetic environment for open-trade policies and to *sustain* such policies. Politicians might be willing to tilt this or that particular decision toward a trade-friendly outcome if persuaded that it is good for their specific constituencies even without a sense of strong public support—a point worth returning to. But the initial reaction of politicians will more likely be favorable—and certainly more likely to remain favorable over time—if the public seems solidly behind open trade. Politicians seemed much more kindly disposed to companies that market tobacco products when they sensed a lower level of public hostility. This point is obvious, but many discussions of building support for trade skip past the public and focus on building political coalitions among specific politicians or specific industry groups.

The difficulties faced here have been sketched out. But three tacks seem especially promising:

First, simple analogies such as offered earlier—the make-your-own-clothes analogy—are much more effective than abstract theorizing. Repeatedly putting these analogies in the public domain can help.

Second, linking trade to economic success by contrasting open-trade and closed-trade regimes can persuade some people. Comparing

Argentina and America, Hong Kong and China, Singapore and Pakistan, Eastern Europe and Western Europe can help. There is significant public sympathy for the argument that insulation from trade played a significant role in the growing gap that separated the two Europes between 1950 and 1990. The argument links easily to concerns about trade bringing increased competition. Japanese car imports forced American car manufacturers to make substantial improvements in design, durability, and cost. That's what trade does. And if imports are there, competing, all along, there's less need for a sudden, major adjustment.

Third, people understand that jobs are good and can be impressed that increases in imports as well as exports create jobs. This argument is critical and tricky. But it must be pushed.

Politicians are much more likely to resonate to the last of these three arguments than to the first two. Most politicians have a seriously underdeveloped appreciation for general equilibrium analysis, for connections of cause and effect that have more than one step. But they like to hear about job creation in their districts. Hammering home the figures on what trade means for jobs in their political base helps. And hearing from businessmen—especially from businessmen a politician will not think of as too close to foreign interests (the Honda official does not come in with the same aura that the Caterpillar official does)—makes a difference. Business leaders have significant influence on business issues. They need to repeatedly tell political leaders how important trade is to them and how counterproductive it is to try to fit all of the public's concerns inside a trade negotiation.

This is what's needed. And the expansion of trade throughout our economy should make it easier. But most Americans, politicians, and the general public alike remain committed to mercantilist concepts that economists knew to be wrong more than 200 years ago. Like most building trades, building support for open trade requires a hard hat.

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BUILDING ON THE WTO'S SUCCESS

William A. Niskanen

The World Trade Organization may be the single most effective international agency. With the pending inclusion of China, governments that represent 85 percent of the world's population and about 95 percent of world trade have chosen to bind themselves to the WTO's rules and dispute settlement procedures. The WTO has been so successful that numerous groups have petitioned to use the WTO to enforce a range of nontrade rules affecting labor, the environment, and competition policy. Moreover, I think the WTO is a bargain. The budget of the WTO is around \$80 million a year, barely more than the rounding error in U.S. federal budgets.

The reasons for the relative success of the WTO are that it has been focused on modest and broadly shared trade concerns—modest because the WTO, almost alone among international bureaucracies, has self-consciously resisted both internal and external pressures to expand its mission. The contrast with the International Monetary Fund and World Bank, for example, could not be stronger.

The Threat of Overloading the WTO

Despite its effectiveness, the WTO is a potentially fragile institution. The major threat is the pressure to overload the WTO with the responsibility to enforce a wider range of rules. Attempts by the WTO to enforce such broader rules would almost surely cause some governments to pull out of the organization. Most governments, fortunately, are now more willing to allow private firms to compete across national borders. However, many of these same governments are pressuring the WTO to become a cartel of governments to reduce

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the competition among governments on such matters as labor, environment, and antitrust standards.

International trade provides one benefit that is not provided by domestic trade. International trade, by its nature, creates competition among national rule-setting bodies. Trade across states within the United States creates competition among state rule-setting bodies. Only competition among nations creates competition among national rule-setting bodies. My own view is that reducing competition among governments is too high a price to pay for further increasing international competition among private firms. However valuable the latter, reducing competition among governments, that is, blocking competition among governments by international agreement on these rules, is a much greater threat to our liberty and our economy than the possible reduction of competition among private firms.

The Next Trade Round

Let me develop the implications of these lessons for the next trade round. First, the next trade round, like the WTO, should be focused and modest. Making progress on issues about which there is broad concern is more important than arguing endlessly about issues such as restricting antidumping, which the United States opposes, or about a broader role of the WTO on issues such as labor, the environment, and competition policy, which the governments of the developing countries oppose. The outstanding issues that the next round should address also need to be focused and modest. They should concentrate primarily on the mandated agenda of issues affecting agriculture and services that were not resolved during the prior round.

One new valuable issue to address, or just to introduce, would be to change the standard response to a government's failure to enforce the WTO decision in a dispute settlement—from sanctions by the aggrieved government to compensation by the offending government. The primary response now to targeted protectionism by one government judged to be violating WTO rules is targeted responsive protectionism by the aggrieved government. This response harms both nations' consumers and invites the response of special interest pressure in the aggrieved nation to shape the form of the sanction.

A far superior response is to shift the burden to the offending government to offer other comparable trade barrier reductions. Choosing to maintain rule-breaking barriers in a specific area would help some consumers in the offending countries because they would benefit from reduced trade barriers in other areas. It would also affect some exporters in other countries because the market for some

products in the offending countries would be open. In addition, it would reduce the use of retaliatory sanctions to serve protectionist pressures within the United States. The aggrieved government should be allowed to respond with sanctions only if the offending government fails to offer the compensation that would be comparable to the effect of its actions in not implementing the WTO ruling.

Old issues that should not be addressed in the next round are the imperfect agreement on intellectual property, the aborted agreement on investment, and the various legitimate concerns about the abuse of national antidumping rules, especially by the United States. These are important trade-related issues that should be addressed at some time. I suggest that they would unduly complicate the next round because they are not yet ripe for a broad agreement. New issues that should be avoided at all costs are the proposals to broaden the role of the WTO to enforce international rules on labor, environment, and competition policies, for all the reasons discussed earlier.

Finally, a commitment to a focused and modest trade round should influence one other decision: a short deadline, maybe three years, should be sufficient to address the mandated agenda and would help avoid those issues, right or wrong, for which there is no near-term prospect for a broad agreement.

Cato Institute

Founded in 1977, the Cato Institute is a public policy research foundation dedicated to broadening the parameters of policy debate to allow consideration of more options that are consistent with the traditional American principles of limited government, individual liberty, and peace. To that end, the Institute strives to achieve greater involvement of the intelligent, concerned lay public in questions of policy and the proper role of government.

The Institute is named for *Cato's Letters*, libertarian pamphlets that were widely read in the American Colonies in the early 18th century and played a major role in laying the philosophical foundation for the American Revolution.

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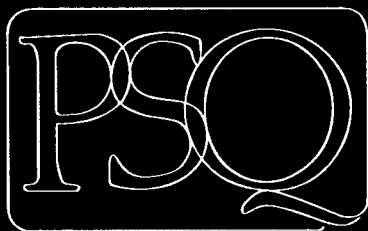
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THE PRIMACY OF TRADE

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—Peter Bauer

From Subsistence to Exchange and Other Essays (Princeton, N.J.: Princeton University Press, 2000), 8.